KING PHARMACEUTICALS INC
Form 10-Q
November 05, 2010

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

OR

o **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	**54-1684963**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
501 Fifth Street, Bristol, TN	**37620**
(Address of principal executive offices)	*(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 þ No o

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 þ No o

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 þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(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 o No þ

Number of shares outstanding of Registrant s common stock as of November 2, 2010: 249,968,580

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PART I FINANCIAL INFORMATION

Item 1. *Financial Statements*

KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 697,520	$ 545,312
Investments in debt securities		29,258
Marketable securities	919	2,100
Accounts receivable, net of allowance of $2,790 and $3,401	215,876	210,256
Inventories	198,382	182,291
Deferred income tax assets	83,979	83,675
Income taxes receivable	9,687	16,091
Prepaid expenses and other current assets	21,917	60,860
Total current assets	1,228,280	1,129,843
Property, plant and equipment, net	368,173	391,839
Intangible assets, net	703,210	794,139
Goodwill	466,283	467,613
Deferred income tax assets	232,246	264,162
Investments in debt securities	155,337	218,608
Other assets (includes restricted cash of $15,913 and $15,900)	57,484	56,496
Assets held for sale	6,567	5,890
Total assets	$ 3,217,580	$ 3,328,590
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 92,085	$ 86,692
Accrued expenses	205,338	320,992
Short-term debt	3,647	3,662
Current portion of long-term debt		85,550
Total current liabilities	301,070	496,896

Long-term debt	346,576	339,016
Other liabilities	123,406	123,371
Total liabilities	771,052	959,283
Commitments and contingencies (Note 9)		
Shareholders equity	2,446,528	2,369,307
Total liabilities and shareholders equity	$ 3,217,580	$ 3,328,590

See accompanying notes.

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KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues:				
Net sales	$ 340,220	$ 451,417	$ 1,046,151	$ 1,296,048
Royalties	34,326	11,932	80,153	41,346
Total revenues	374,546	463,349	1,126,304	1,337,394
Operating costs and expenses:				
Cost of revenues, exclusive of depreciation and amortization shown below	132,651	162,797	378,732	469,829
Selling, general and administrative	114,341	135,742	386,645	394,907
Merger and acquisition related costs	1,147		1,147	6,733
Total selling, general and administrative expense	115,488	135,742	387,792	401,640
Research and development	25,666	22,640	87,164	71,098
Depreciation and amortization	32,679	53,349	143,857	159,560
Restructuring charges (Note 13)	15	1,653	5,129	51,178
Gain on asset held for sale	(677)		(677)	
Total operating costs and expenses	305,822	376,181	1,001,997	1,153,305
Operating income	68,724	87,168	124,307	184,089
Other income (expense):				
Interest income	400	1,027	1,296	5,321
Interest expense	(7,293)	(22,218)	(23,508)	(72,913)
Gain on Kadian® (Note 6)			12,500	
(Loss) gain on investments	(2,476)	521	(3,099)	(826)
Loss on early extinguishment of debt			(2,252)	
Other, net	2,239	1,526	283	2,859
Total other expense	(7,130)	(19,144)	(14,780)	(65,559)
Income before income taxes	61,594	68,024	109,527	118,530
Income tax expense	22,374	25,536	47,850	48,829
Net income	$ 39,220	$ 42,488	$ 61,677	$ 69,701

Net income per common share:				
Basic net income per common share	$ 0.16	$ 0.17	$ 0.25	$ 0.29
Diluted net income per common share	$ 0.16	$ 0.17	$ 0.25	$ 0.28

See accompanying notes.

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KING PHARMACEUTICALS, INC.

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

	Common Stock		Retained	Accumulated Other Comprehensive Income	
	Shares	Amount	Earnings	(Loss)	Total
Balance at December 31, 2008	246,487,232	$ 1,391,065	$ 871,021	$ (28,287)	$ 2,233,799
Adoption of new accounting standard, net of taxes of $396 (Note 3)			646	(646)	
Comprehensive income:					
Net income			69,701		69,701
Reclassification of unrealized losses on investments in debt securities, net of taxes of $542				885	885
Net unrealized gain on marketable securities, net of taxes of $539				880	880
Net unrealized gain on investments in debt securities, net of taxes of $3,354				5,472	5,472
Foreign currency translation				3,227	3,227
Total comprehensive income					80,165
Stock-based award activity	1,739,351	22,811			22,811
Balance at September 30, 2009	248,226,583	$ 1,413,876	$ 941,368	$ (18,469)	$ 2,336,775
Balance at December 31, 2009	248,444,711	$ 1,421,489	$ 963,620	$ (15,802)	$ 2,369,307
Comprehensive income:					
Net income			61,677		61,677
Reclassification of unrealized losses on investments in debt securities, net of taxes of $399				(638)	(638)
Net unrealized loss on marketable securities, net of taxes of $344				(836)	(836)
Net unrealized gain on investments in debt securities, net of taxes of $1,645				2,631	2,631
Foreign currency translation				(4,896)	(4,896)

Total comprehensive income					57,938
Stock-based award activity	1,479,576	19,283			19,283
Balance at September 30, 2010	249,924,287	$ 1,440,772	$ 1,025,297	$ (19,541)	$ 2,446,528

See accompanying notes.

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KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2010	**2009**
Cash flows provided by operating activities	$ 139,624	$ 262,164
Cash flows from investing activities:		
Transfers to restricted cash	(13)	(69)
Proceeds from maturities and sales of investments in debt securities	95,895	38,473
Purchases of property, plant and equipment	(22,835)	(29,608)
Proceeds from sale of property and equipment	252	337
Proceeds from sale of Kadian®	47,500	59,800
Acquisition of Alpharma		(70,230)
Forward foreign exchange contracts		(8,906)
Purchases of intellectual property and product rights	(3,738)	(2,186)
Net cash provided by (used in) investing activities	117,061	(12,389)
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,723	1,742
Net payments related to stock-based award activity	(5,003)	(3,554)
Payments on debt	(92,276)	(710,429)
Debt issuance costs	(4,621)	(1,313)
Net cash used in financing activities	(100,177)	(713,554)
Effect of exchange rate changes on cash	(4,300)	3,535
Increase (decrease) in cash and cash equivalents	152,208	(460,244)
Cash and cash equivalents, beginning of period	545,312	940,212
Cash and cash equivalents, end of period	$ 697,520	$ 479,968

See accompanying notes.

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 and 2009
(In thousands, except share and per share data)
(Unaudited)

1. General

The accompanying unaudited 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 nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. These unaudited 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 included in this Form 10-Q was derived from the audited Consolidated Financial Statements, but does not include all disclosures required by generally accepted accounting principles.

These unaudited 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

Basic and diluted income per common share were determined using the following share data:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Basic net income per common share:				
Weighted average common shares	245,982,811	244,963,911	245,658,409	244,515,264
Diluted net income per common share:				
Weighted average common shares	245,982,811	244,963,911	245,658,409	244,515,264
Effect of stock options	167,360	115,844	364,925	47,087
Effect of dilutive share awards	3,616,481	3,185,797	3,646,116	2,807,487
Weighted average common shares	249,766,652	248,265,552	249,669,450	247,369,838

For the three months ended September 30, 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 6,532,380 shares of

common stock, 616,614 restricted stock awards (RSAs) and 872,720 long-term performance units (LPUs). For the nine months ended September 30, 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 5,083,569 shares of common stock, 504,743 RSAs and 619,206 LPUs. For the three months ended September 30, 2009, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted income per common share, included options to purchase 5,010,109 shares of common stock and 138,640 LPUs. For the nine months ended September 30, 2009, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted income per common share included options to purchase 6,356,694 shares of common stock, 202,632 RSAs and 221,362 LPUs. 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 the calculations of diluted

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

income 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 three and nine months ended September 30, 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 September 30, 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 of the Company s prior credit agreements required the Company to maintain hedging agreements that fixed 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 was at fixed rates and therefore an interest rate swap was no longer required. The Company terminated the interest rate swap in the third quarter of 2009 for $838 and recognized the cost as interest expense in the accompanying Condensed Consolidated Statement of Operations.

The following tables summarize the effect of derivative instruments on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2009:

	Three Months Ended September 30, 2009			Nine Months Ended September 30, 2009		
	Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income	Gain or (Loss) in Other Comprehensive	Gain or (Loss)	Gain or (Loss) Reclassified from Accumulated Other Comprehensive	Gain or (Loss) in Other Comprehensive	Gain or (Loss)

Derivatives in Cash Flow Hedging Relationships	on Derivative (Effective Portion)	Income into Income (Effective Portion)	Recorded in Income (Ineffective Portion)	Income on Derivative (Effective Portion)	Income into Income (Effective Portion)	Recorded in Income (Ineffective Portion)
Interest rate swap	$	$ (232)	$ (606)	$	$ (232)	$ (606)

Derivatives not Designated as Hedging Instruments		Three Months Ended September 30, 2009 Gain or (Loss) Recognized in Income on Derivative	Nine Months Ended September 30, 2009 Gain or (Loss) Recognized in Income on Derivative
Foreign currency contracts	Other Income	$ (5,789)	$ (5,360)

Marketable Securities. As of September 30, 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 $408 and $1,589, respectively, as of September 30, 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 7, 28 or 35 days. On February 11, 2008, the Company began to experience auction failures with respect to its investments in auction rate

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

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) gain 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 September 30, 2010 and December 31, 2009, the par value of the Company s investments in debt securities was $184,975 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 September 30, 2010, there were cumulative unrealized holding losses of $21,388 recorded in accumulated other comprehensive income (loss) on the Condensed Consolidated Balance Sheet associated with investments in debt securities with a par value of $169,975, which were classified as available for sale. All of these investments in debt securities have been in continuous unrealized loss positions for greater than 12 months. As of September 30, 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 income (expense) 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). During the third quarter of 2010, the Company recognized $2,460 of additional other-than-temporary credit losses related to this municipal bond.

During the third quarter of 2010, the Company sold an auction rate security associated with student loans with a par value of $500 for $485 to the issuer and realized a loss of $15 in the Condensed Consolidated Statements of Operations. 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 Statements of Operations. During the second quarter of 2009, the Company sold certain auction rate securities associated with student loans with a par value of $20,350 for $18,923 to the issuer and realized a loss of $1,427 in the Condensed Consolidated Statements 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). During the second quarter of 2010, the Company notified UBS of its intent to sell the auction rate securities related to this offer. During the third quarter of 2010, the Company sold all the auction rate securities that were included in the UBS right for par value of $18,200. The Company did not

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognize any gain or loss on the exercise of the right and the sale of the securities. At December 31, 2009, the Company held auction rate securities related to this offer with a par value of $32,500. The Company elected the fair value option to account for this right. As a result, gains and losses associated with this right were 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 December 31, 2009, the fair value of the right to sell the auction rate securities to UBS at par was $3,226. With respect to this right, the Company recognized unrealized losses of $1,854 and $3,226 during the third quarter and first nine months of 2010, respectively, and an unrealized gain of $44 and an unrealized loss of $413 during the third quarter and first nine months of 2009 respectively, in Other income (expense) in the accompanying Condensed Consolidated Statements of Operations.

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 December 31, 2009, the fair value of the investments in debt securities classified as trading was $29,258. The Company recognized unrealized gains related to these securities of $1,854 and $3,242 during the third quarter and first nine months of 2010, respectively, and $477 and $1,014 during the third quarter and first nine months of 2009, respectively, in Other income (expense) in the accompanying Condensed Consolidated Statements of Operations.

As of September 30, 2010, the Company had classified all of its auction rate securities as long-term assets.

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

		Fair Value Measurements at September 30, 2010 Using		
Description	**Total Fair Value at 09/30/2010**	**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	$ 664,391	$ 664,391	$	$
U.S. Government Securities	4,139	4,139		
Marketable Securities	919	919		
Investments in Debt Securities	155,337		6,750	148,587
Total Assets	$ 824,786	$ 669,449	$ 6,750	$ 148,587

Fair Value Measurements at December 31, 2009 Using

Description	Total Fair Value at 12/31/2009	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	$ 518,950	$ 518,950	$	$
U.S. Government Securities	4,138	4,138		
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.

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The fair value of investments in debt securities within the Level 2 classification is based on observed market trading activity for securities with similar terms and characteristics.

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 determined by the model. As of September 30, 2010, the Company assumed a weighted average discount rate of 3.9% 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 September 30, 2010. Transfers out of Level 3 classification occur when public call notices have been announced by the issuer prior to the date of the valuation or when observable market trading activity for securities with similar terms and characteristics is available.

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

	2010	2009
Beginning balance, January 1	$ 251,092	$ 361,913
Total gains (losses) (realized/unrealized)		
Included in earnings	(872)	(823)
Included in other comprehensive income (loss)	927	(4,300)
Settlements	(16,810)	(8,000)
Transfers into (out of) Level 3	(3,750)	1,700
Ending balance, March 31	$ 230,587	$ 350,490
Total gains (losses) (realized/unrealized)		
Included in earnings	249	(524)
Included in other comprehensive income (loss)	4,441	13,781
Settlements	(51,050)	(25,650)
Transfers into (out of) Level 3	3,750	700
Ending balance, June 30	$ 187,977	$ 338,797
Total gains (losses) (realized/unrealized)		
Included in earnings	(2,476)	521
Included in other comprehensive income (loss)	(2,129)	2,201
Settlements	(28,035)	(6,250)
Transfers into (out of) Level 3	(6,750)	

Ending balance, September 30	$ 148,587	$ 335,269

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Inventories

Inventories consist of the following:

	September 30, 2010	December 31, 2009
Raw materials	$ 62,033	$ 62,054
Work-in-process	38,718	29,979
Finished goods (including $2,017 and $3,908 of sample inventory, respectively)	142,226	126,705
	242,977	218,738
Inventory valuation allowance	(44,595)	(36,447)
Total inventories	$ 198,382	$ 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. During the third quarter of 2010, the Company recorded a gain of $677 based on the estimated fair value of this asset at September 30, 2010. During October 2010, the Company sold this facility for $6,567.

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.

6. Acquisitions, Dispositions, Co-Promotions and Alliances

Kadian®

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.

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Actavis LLC paid a purchase price 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 purchase price payment associated with each calendar quarter is as follows:

	Purchase Price Payment
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

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. The Company recorded a gain of $12,500 in the second quarter of 2010 as a result of the divestiture. In accordance with the agreement, quarterly payments were received one quarter in arrears. During the third quarter and first nine months of 2010, the Company received $7,500 and $47,500, respectively, from Actavis LLC related to gross profit from sales during the fourth quarter of 2009 and the first six months of 2010.

Skelaxin® Authorized Generic

In January 2008, the Company entered into an agreement with CorePharma, LLC (CorePharma) granting CorePharma a license to launch an authorized generic version of Skelaxin® under certain conditions. In accordance with this agreement, the Company receives a fee based on CorePharma s gross profit, as defined by the agreement, of the authorized generic product. During the second and third quarters of 2010, the Company recognized revenue of $25,624 and $25,223, respectively, related to the gross profit of the CorePharma Skelaxin® authorized generic which is recorded in royalties. In addition, the Company sells the related active pharmaceutical ingredient to CorePharma for their manufacture of the authorized generic.

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:

	September 30, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Branded prescription pharmaceuticals	$ 1,266,936	$ 848,402	$ 1,264,250	$ 764,327
Alpharma Animal Health	170,083	16,852	170,000	9,633

Meridian Auto-Injector	187,536	56,279	183,249	49,621
Royalties and other	3,731	3,543	3,731	3,510
Total intangible assets	$ 1,628,286	$ 925,076	$ 1,621,230	$ 827,091

Amortization expense for the three months ended September 30, 2010 and 2009 was $18,335 and $38,011, respectively. Amortization expense for the nine months ended September 30, 2010 and 2009 was $97,985 and $114,338, 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. In August 2010, the Court of Appeals for the Federal Circuit affirmed the actions of the District Court. Generic versions of Skelaxin® entered the market early

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in the second quarter of 2010. The Company s sales of Skelaxin® have declined significantly and will continue to decline as a result of generic competition. Net sales of Skelaxin® were $400,998 in 2009 and $6,781 and $103,017, respectively, in the three and nine months ended September 30, 2010. According to IMS America, Ltd. weekly prescription data, for the week ending October 22, 2010, generic competitors have garnered approximately 85% of the prescriptions in the metaxalone market. The intangible assets associated with Skelaxin® were fully amortized in the second quarter of 2010. The amortization expense associated with Skelaxin® in the first six months of 2010 was $43,226.

For additional information regarding Skelaxin® litigation, please see Note 9.

Goodwill at September 30, 2010 and December 31, 2009 is as follows:

	Branded Prescription Pharmaceuticals Segment	Alpharma Animal Health Segment	Meridian Auto-Injector Segment	Total
Goodwill at December 31, 2009	$ 267,024	$ 92,179	$ 108,410	$ 467,613
Adjustment to Alpharma acquisition		(1,330)		(1,330)
Goodwill at September 30, 2010	$ 267,024	$ 90,849	$ 108,410	$ 466,283

8. Long-Term Debt

Long-term debt consists of the following:

	September 30, 2010	December 31, 2009
Convertible senior notes	$ 346,576	$ 332,305
Senior secured revolving credit facility		92,261
Total long-term debt	346,576	424,566
Less current portion		85,550
Long-term portion	$ 346,576	$ 339,016

Convertible Senior Notes

At September 30, 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:

	September 30, 2010	December 31, 2009
Gross carrying amount	$ 400,000	$ 400,000
Unamortized debt discount	53,424	67,695
Net carrying amount	$ 346,576	$ 332,305

Senior Secured Revolving Credit Facility

On May 11, 2010, the Company entered into a new $500,000 five-year Senior Secured Revolving Credit Facility (2010 Revolving Credit Facility) with Credit Suisse AG, as Administrative Agent (the Administrative Agent) and terminated the existing $475,000 Senior Secured Revolving Credit Facility (2008 Revolving Credit

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Facility) entered into April 19, 2007 and amended December 5, 2008, which was scheduled to mature in April 2012. The 2010 Revolving Credit Facility provides the Company with aggregate revolving credit commitments of $500,000, with a $50,000 sublimit for the issuance of letters of credit. The 2010 Revolving Credit Facility also provides for an incremental term loan facility in an aggregate amount of up to $500,000. The 2010 Revolving Credit Facility matures on May 11, 2015.

The undrawn commitment amount under the 2010 Revolving Credit Facility on September 30, 2010 totals $496,291 after giving effect to letters of credit totaling $3,709.

Prior to the termination of the 2008 Revolving Credit Facility, the Company made payments of $92,261 on this facility in the first quarter of 2010, which represented full payment on all outstanding borrowings under the facility. During the three and nine months ended September 30, 2009, the Company made payments of $18,584 and $152,769, respectively, on the 2008 Revolving Credit Facility.

In connection with the establishment of the 2010 Revolving Credit Facility, the Company incurred approximately $4,622 of new deferred financing costs. During the second quarter of 2010, the Company expensed $2,252 of the $4,287 of deferred financing costs that remained outstanding at the time of the termination of the 2008 Revolving Credit Facility. Therefore, deferred financing costs associated with the 2010 Revolving Credit Facility total $6,657 and are being amortized over five years.

The Company s borrowings under the 2010 Revolving Credit Facility will bear interest at annual rates that, at the Company s option, will be either:

a base rate generally defined as the sum of (i) the greatest of (a) the prime rate of the Administrative Agent, (b) the federal funds effective rate plus 0.5% and (c) the one-month adjusted London Interbank Offered (LIBO) rate (by reference to the British Bankers Association Interest Settlement Rates for deposits in dollars) plus 1.0% and (ii) an applicable percentage of 1.50%, 1.75% or 2.00%, depending on the Company s corporate credit rating; or

an adjusted LIBO rate generally defined as the sum of (i) the product of (a) the LIBO rate (by reference to the British Bankers Association Interest Settlement Rates for deposits in dollars) in effect for the relevant interest period and (b) a fraction, the numerator of which is one and the denominator of which is one minus certain maximum statutory reserves for eurocurrency liabilities and (ii) an applicable percentage of 2.50%, 2.75% or 3.00%, depending on the Company s corporate credit rating.

If the Company makes any borrowings under the incremental term loan facility, those borrowings will bear interest at annual rates established at the time of the borrowings.

The Company is required to pay an unused commitment fee on the difference between committed amounts and amounts actually borrowed under the 2010 Revolving Credit Facility equal to an applicable percentage of 0.375% or 0.5% per annum, depending on the Company s corporate credit rating. The Company is required to pay a letter of credit participation fee based upon the aggregate face amount of outstanding letters of credit equal to an applicable percentage of 2.5%, 2.75% or 3.0% per annum, depending on the Company s corporate credit rating.

The 2010 Revolving Credit Facility contains customary representations and warranties and affirmative covenants. The 2010 Revolving Credit Facility also contains certain covenants that restrict, among other things, the ability of the Company and its subsidiaries to incur additional indebtedness, permit certain liens to exist on its respective assets, enter into sale and leaseback transactions, make investments, loans and advances, undertake acquisitions, mergers and consolidations, sell assets, make dividend and other restricted payments, enter into transactions with affiliates, prepay, redeem or repurchase other indebtedness and make capital expenditures, in each case, subject to certain exceptions.

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The 2010 Revolving Credit Facility also requires the Company to meet the following financial tests:

maintenance of a minimum consolidated EBITDA to consolidated interest expense ratio for periods of four consecutive fiscal quarters of 3.50 to 1; and

maintenance of a maximum total funded debt to consolidated EBITDA ratio of 3.0 to 1.

The 2010 Revolving Credit Facility also contains customary events of default, including events of default based on failures to make payments as and when required under the 2010 Revolving Credit Facility, breaches of representations, warranties and covenants, defaults under certain other material indebtedness, the occurrence of certain bankruptcy and insolvency events related to the Company and certain of its subsidiaries, the levy of judgments in excess of specified amounts, the occurrence of certain ERISA events, certain impairments to the guarantees of the Company s obligations under the credit facility, certain impairments of the security interests granted by the Company and the subsidiary guarantors in connection with the 2010 Revolving Credit Facility and a change in control of the Company.

The Company s obligations under the 2010 Revolving Credit Facility are guaranteed by each of the Company s domestic subsidiaries and secured by pledges by the Company of certain of its assets, including equity interests in certain of the Company s subsidiaries and intellectual property.

Senior Secured Term Facility

In connection with the acquisition of Alpharma on December 29, 2008, the Company entered into a $200,000 Senior Secured Term Facility with a maturity date of December 28, 2012. The Company borrowed $200,000 under the Senior Secured Term Facility and received proceeds of $192,000, net of the discount at issuance. During the three and nine months ended September 30, 2009, the Company made payments of $105,489 and $171,305, respectively, 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

Legal Proceedings Related to the Pfizer Transaction

Since the announcement on October 12, 2010 of the Company s entry into an agreement and plan of merger with Pfizer Inc. and a wholly-owned subsidiary of Pfizer Inc. (Pfizer) (see Note 15, Subsequent Event), a

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number of putative class action lawsuits have been filed in federal and state court in Tennessee by purported shareholders of the Company on behalf of themselves and other shareholders of the Company. The complaints name as defendants the Company and its directors and, in certain cases, Pfizer.

The complaints variously allege, among other things, that the Company s directors breached their fiduciary duties to shareholders of the Company in connection with the Company s entry into the agreement and plan of merger with Pfizer. Certain of the complaints also allege that the Company and/or Pfizer aided and abetted the directors purported breaches of fiduciary duties. The complaints seek, among other things, class action status, an order enjoining the proposed transaction, and attorneys fees and expenses.

Intellectual Property Matters

Skelaxin®

Eon Labs, Inc. (Eon Labs), 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®, are 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 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 May 6, 2010, the Court granted a preliminary injunction against CorePharma. On May 19, 2010, the Court entered a consent order from the parties vacating the preliminary injunction, and CorePharma resumed selling the authorized generic form of Skelaxin®.

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

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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 fully briefed by the parties. On September 2, 2010, the Court dismissed all of Eon Labs pending counterclaims. On September 10, 2010, the Court denied Eon Labs motion for exceptional case. 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. Oral argument of the appeal was heard by the Federal Circuit on May 7, 2010. On August 2, 2010, the Federal Circuit affirmed the district court s grant of summary judgment and vacated the order against Elan for lack of subject matter jurisdiction. A petition for panel rehearing and rehearing en banc was filed on September 21, 2010. The Federal Circuit Court denied the petition on October 14, 2010. On October 26, 2010, Eon filed a Notice of Appeal to the Federal Circuit to appeal the district court s decision on its motion for exceptional case.

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, Inc. (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® and is listed in the FDA s Orange Book; it 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.

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 using, offering to sell, or selling 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 preliminary injunction motion was denied on May 17, 2010. On June 1, 2010, the Company filed an amended complaint to include claims for monetary damages. On June 15, 2010, Sandoz answered the amended complaint and filed amended counterclaims. The Company s request for a jury trial was also granted and the trial date for the patent litigation against Sandoz was set for September 7, 2010. The trial concluded on September 16, 2010. The jury found the 566 patent invalid and not infringed. On

October 18, 2010, the plaintiffs filed post-trial motions.

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

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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.

Avinza®

Actavis, Inc. (Actavis) filed an ANDA with the FDA seeking permission to market generic versions of Avinza® 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® 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.

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.

The Court held a claim construction hearing on March 19, 2010 and issued a ruling. The Court scheduled trial to begin on February 7, 2011. The close of all discovery is currently set for January 7, 2011.

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

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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. A claim construction hearing was held on September 30, 2010 and the Court issued a ruling on October 1, 2010. Trial is currently set for May 9, 2011.

The Company intends to vigorously defend its rights under the 339 patent. Net sales of Avinza® were $131,148 in 2009 and $27,281 and $75,218, respectively, in the three and nine months ended September 30, 2010. As of September 30, 2010, the Company had net intangible assets related to Avinza® of $195,178. If a generic form of Avinza® 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®

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® 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. A claim construction hearing is set for September 15, 2011 and trial is currently set for February 16, 2012. The parties are in the midst of fact discovery.

On June 4, 2010, the Company received a Paragraph IV certification from Sandoz 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 July 14, 2010, the Company filed suit against Sandoz in the U.S. District Court for District of New Jersey to defend its rights under the 012 patent.

On September 13, 2010, Sandoz answered the complaint and filed counterclaims of noninfringement and invalidity. The Company filed a reply on October 7, 2010. An initial scheduling conference is set for December 2, 2010.

On September 14, 2010, the U.S. Patent and Trademark Office issued U.S. Patent No. 7,794,432 (the 432 patent) covering the NGA for use with epinephrine sold under the EpiPen® brand name. The 432 patent expires September 11, 2025. The 432 patent was listed in FDA s Orange Book on September 15, 2010 under the EpiPen® NDA. On September 17, 2010, the Company sent notice to Teva and Sandoz that it had added the 432 patent to the FDA Orange Book.

On November 2, 2010, the Company received a Paragraph IV certification from Teva challenging the validity and alleging non-infringement of the 432 patent. The Company is evaluating the certification and intends to vigorously enforce its intellectual property related to EpiPen®.

Embeda®

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®. 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

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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 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®. 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 was set for August 18, 2010, for both the 088 and the 939 patents. On April 2, 2010, Purdue s action brought in the U.S. District Court for the District of New Jersey was dismissed. On June 22, 2010, the Court issued its opinion and order regarding claim construction.

On July 23, 2010, the Company and Alpharma (collectively the King Parties) entered into a settlement agreement with Purdue. Pursuant to the terms of the agreement, Purdue agreed not to sue the King Parties or their affiliates in the United States with regard to the manufacture, use or sale of Embeda®. The King Parties are obligated to pay to Purdue an up-front payment, which was paid in the third quarter of 2010, and a quarterly royalty on net sales of Embeda® for the duration of any valid claims in the 088 and 939 patents, or other patents in the same family that cover the Embeda® product beginning on August 1, 2010. In addition, the King Parties agreed not to challenge certain of Purdue s patents, including the 088 and 939 patents, as they may relate to Embeda®. The agreement also obligates the parties to dismiss the civil action pending in the District Court for the Western District of Virginia.

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

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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 AWPs 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. Trials scheduled to begin in 2010 have been stayed or continued pending a ruling on the Sandoz appeal. 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 was scheduled for trial in January 2011 but, as with other scheduled cases, this trial date was continued as a result of the Alabama 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, Oklahoma s, filed in September 2010 and Louisiana s, filed in October 2010. The Company expects the Oklahoma case to be voluntarily dismissed. 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 Alpharma 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, was originally a defendant in numerous cases. These lawsuits were 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), was one of many defendants, including manufacturers and other distributors of these drugs. Although Jones did not at any time

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manufacture dexfenfluramine, fenfluramine or phentermine, Jones was a distributor of a generic phentermine product and, after its acquisition of Abana Pharmaceuticals (Abana), was a distributor of Obenix®, 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. All of the cases involving King Research and Development have been dismissed.

Hormone Replacement Therapy

Currently, the Company is named as a defendant by 20 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 20 lawsuits were filed in Alabama, Arkansas, California, 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. Most of the trials have involved 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 several jury verdicts. One of these verdicts was later reversed, and one other was partially reversed. 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.

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

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3.125% per annum. During the first quarter of 2010, Alpharma entered into a definitive settlement agreement and paid $42,500 plus interest of $648 to the DOJ, of which $8,876 plus interest of $161 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 138 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 approximately $8,231 and $22,466, respectively, in the three and nine months ended September 30, 2010.

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 Kadian® 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.

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In addition, Alpharma s New York and Iowa cases are pending in the MDL Court discussed above, and the Oklahoma case is pending in the District Court of Pottawotomie County, Oklahoma. 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 April 2010, the FASB issued a standard that provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for certain research and development transactions. Under this new standard, a company can recognize as revenue consideration that is contingent upon achievement of a milestone in the period in which it is achieved, if the milestone meets all criteria to be considered substantive. This standard will be effective for us on a prospective basis for periods beginning after January 1, 2011. The Company does not anticipate the standard will have a material effect on its financial statements.

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

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Income Taxes

During the three and nine months ended September 30, 2010, the Company s effective income tax rate was 36.3% and 43.7%, respectively. During the three months and nine months ended September 30, 2009, the Company s effective income tax was 37.5% and 41.2%, respectively. These rates are higher than the statutory rate of 35% primarily due to losses from foreign subsidiaries with no tax benefit, taxes related to stock compensation and state taxes.

12. Segment Information

The Company s business is classified into four reportable segments: branded prescription pharmaceuticals, Alpharma 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 Alpharma 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 includes 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 profit is defined as operating income (loss) before other expenses such as depreciation, amortization, restructuring charges and merger and acquisition related costs. Additionally, segment profit does not include general corporate expenses, which are included in Corporate costs in the table below. Prior year results have been conformed to the current presentation.

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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.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Total revenues:				
Branded prescription pharmaceuticals(1)	$ 160,750	$ 283,414	$ 564,534	$ 836,228
Alpharma Animal Health	92,656	95,843	258,643	258,502
Meridian Auto-Injector	83,613	71,841	216,142	200,539
Royalties and other	38,469	12,976	89,528	44,862
Eliminations	(942)	(725)	(2,543)	(2,737)
Total revenues	$ 374,546	$ 463,349	$ 1,126,304	$ 1,337,394
Segment profit:				
Branded prescription pharmaceuticals(1)(2)	$ 24,582	$ 106,059	$ 96,357	$ 329,032
Alpharma Animal Health(2)	21,760	19,891	61,039	25,050
Meridian Auto-Injector	46,544	35,878	121,481	100,987
Royalties and other	24,620	11,015	60,335	37,873
Corporate costs	(15,618)	(30,673)	(65,449)	(91,382)
Merger and acquisition related costs	(1,147)		(1,147)	(6,733)
Depreciation and amortization	(32,679)	(53,349)	(143,857)	(159,560)
Restructuring charges	(15)	(1,653)	(5,129)	(51,178)
Gain on asset held for sale	677		677	
Other income (expense)	(7,130)	(19,144)	(14,780)	(65,559)
Income before income taxes	$ 61,594	$ 68,024	$ 109,527	$ 118,530

(1) Branded prescription pharmaceuticals revenues and segment profit do not include the revenue recognized related to the Company s agreement with CorePharma, under which the Company provides CorePharma with a license to launch an authorized generic version of Skelaxin®. In accordance with the agreement, the Company receives a fee based on CorePharma s gross profit, as defined in the agreement, of the authorized generic product. This revenue is recorded in royalties and other.

(2) The segment profit for branded prescription pharmaceuticals for the three months ended September 30, 2009 includes a charge of $2,566 related to the mark up of inventory upon acquisition of Alpharma, which the Company recognized as the related inventory was sold. The segment profit for branded prescription pharmaceuticals and Alpharma animal health for the nine months ended September 30, 2009 includes charges related to the mark up of inventory upon acquisition of Alpharma of $6,022 and $34,128, respectively.

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Total revenues:				
Neuroscience	$ 83,727	$ 185,908	$ 317,330	$ 513,862
Hospital	35,505	46,350	115,465	151,007
Legacy:				
Cardiovascular/metabolic	24,169	35,507	79,946	113,293
Other	17,349	15,649	51,793	58,066
Branded prescription pharmaceutical revenues	$ 160,750	$ 283,414	$ 564,534	$ 836,228

13. Restructuring Activities

Second Quarter of 2010 Action

During the second quarter of 2010, management completed an evaluation of the commercial operations organization within the branded prescription pharmaceuticals segment. As a result of this evaluation, the Company made changes in the management of its commercial operations organization, and a number of employees departed the Company, including the Chief Commercial Officer. The Company also eliminated certain sales territories to better focus on higher potential territories.

The Company has estimated that the total costs associated with this restructuring plan will be approximately $5,176 for severance pay and other employee related costs, which includes approximately $3,341 of cash expenditures and $1,651 of non-cash costs incurred in the second and third quarters of 2010. The remaining severance pay is expected to be fully paid by the third quarter of 2011.

The restructuring charges include employee termination costs associated with a workforce reduction of approximately 30 employees, all of which were members of the commercial operations organization within the branded prescription pharmaceuticals segment.

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®. In June 2009, the Court entered judgment against the Company. In August 2010, the Court of Appeals for the Federal Circuit affirmed the actions of the District Court. Generic versions of Skelaxin® entered the market early in the second quarter of 2010. The Company s sales of Skelaxin® have declined significantly and are expected to continue to decline as a result of generic competition. For additional information regarding Skelaxin® litigation, please see Note 9.

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 fourth quarter of 2010.

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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 $70,711 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 $16,458 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 Levoxyl® from its St. Petersburg, Florida facility to its Bristol, Tennessee facility, which the Company expects to complete in 2011. 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 substantially paid by the first quarter of 2011.

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

	Accrued Balance at December 31, 2009	Income Statement Impact	Cash Payments	Non-Cash Costs	Accrued Balance at September 30, 2010
Second quarter of 2010 Action					
Employee separation payments	$	$ 5,123	$ 3,288	$ 1,651	$ 184
Contract termination		53	53		
Third quarter of 2009 action					
Employee separation payments	1,080	59	1,131		8
First quarter of 2009 action					
Employee separation payments	314	24	337		1
Accelerated depreciation(1)		(45)		(45)	
Fourth quarter of 2008 action					
Employee separation payments	16,177	(296)	11,262	(699)	5,318
Contract termination	9,193	265	3,423	(649)	6,684
Other	182	(182)			
Third quarter of 2006 action					

Employee separation payments	1,185	83	24	13	1,231
	$ 28,131	$ 5,084	$ 19,518	$ 271	$ 13,426

(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.

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14. Stock-Based Compensation

During the third quarter of 2010, the Company granted to certain employees 176,200 RSAs and 40,000 nonqualified stock options pursuant to its Incentive Plan.

During the second quarter of 2010, the Company granted 9,500 RSAs to certain employees, pursuant to its Incentive Plan, and 145,809 restricted stock units (RSUs) were granted to non-employee directors.

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

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

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 for 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 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 achievement of 2010 operating targets. LPUs with a three-year performance cycle will be earned based on achievement of 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.

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. Subsequent Event

On October 11, 2010, King entered into an agreement and plan of merger (the Merger Agreement) with Pfizer pursuant to which Pfizer has agreed to commence a tender offer to purchase all of the outstanding shares of common stock, no par value per share, of King (the Shares) for $14.25 per Share net to the seller in cash (the Offer). Pfizer commenced the Offer on October 22, 2010. The Offer expires on November 19, 2010, unless extended in accordance with the terms of the Merger Agreement. Completion of the Offer is subject to customary conditions including, among others, (i) a majority of the Shares issued and outstanding (on a fully-diluted basis, without giving effect to compensatory equity awards that may be validly cancelled under the Merger Agreement upon completion of the Offer) being validly tendered and not validly withdrawn and (ii) the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, expiring and all other authorizations, consents, and approvals of or notices or filings with any foreign antitrust or competition regulatory authority having been made or obtained.

Subject to the terms and conditions of the Merger Agreement, King has granted Pfizer an irrevocable option (the Top-Up Option) to purchase an aggregate number of newly-issued shares of King common stock that, at the time of such exercise, and when added to the Shares owned by Pfizer or any of its subsidiaries, constitutes one Share more than 90% of the Shares that would be outstanding immediately after the issuance of Shares pursuant to such exercise (on a fully diluted basis), subject to there being authorized Shares available for issuance. The Top-Up Option is exercisable only after Shares have been purchased by Pfizer pursuant to the Offer. The consideration for each Share acquired upon exercise of the Top-Up Option will be the Offer price.

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Merger Agreement prohibits King from soliciting or initiating discussions with third parties regarding other proposals to acquire King and King has agreed to restrictions on its ability to respond to such proposals, subject to certain exceptions. The Merger Agreement also contains customary termination provisions for King and Pfizer. Upon termination of the Merger Agreement, under specified circumstances King will be required to pay to Pfizer a termination fee of $110 million (or $75 million if the basis for the actions giving rise to such termination was King s receipt, within 30 days of the date of the Merger Agreement, of an alternative acquisition proposal that King s Board of Directors determines in good faith constitutes or could be reasonably expected to result in a superior proposal). In addition, the Merger Agreement contains representations, warranties and covenants of the parties customary for transactions of this type.

In connection with the Merger Agreement, in October 2010 the Board of Directors approved payments of awards under certain of King s employee incentive award plans for the 2010 performance period, which will be recognized and paid in the fourth quarter of 2010. In addition, the Company expects to incur fees for its legal and financial advisors related to the merger with Pfizer. In the aggregate, the costs described in this paragraph are estimated to approximate $50 to $60 million.

16. Guarantor Financial Statements

Each of the Company s U.S. subsidiaries (the Guarantor Subsidiaries) guarantees 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.

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

GUARANTOR SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEETS
(In thousands)
(Unaudited)

	September 30, 2010				December 31, 2009			
	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	King Consolidated	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimin Entr
ASSETS									
	$ 403,533	$ 55,653	$ 238,334	$	$ 697,520	$ 277,603	$ 30,779	$ 236,930	$
						29,258			
	919				919	2,100			
	28,836	151,188	35,852		215,876	2,467	174,713	33,076	
	40,742	125,338	34,140	(1,838)	198,382	43,834	111,242	28,642	(
	29,945	53,577	457		83,979	30,828	52,597	250	
	9,644	383	(340)		9,687	17,983	(1,865)	(27)	
	10,888	9,520	1,509		21,917	14,972	44,384	1,504	
	524,507	395,659	309,952	(1,838)	1,228,280	419,045	411,850	300,375	(
	141,033	218,740	8,400		368,173	148,399	234,233	9,207	
		670,113	33,097		703,210		759,583	34,556	
		466,283			466,283		467,613		
	(30,458)	262,158	546		232,246	(26,551)	290,104	609	
	155,337				155,337	218,608			
	36,850	20,290	344		57,484	32,368	23,795	333	
		6,567			6,567		5,890		
	3,085,856	919,997	(129)	(4,005,724)		3,027,491	938,020	(88)	(3,96
	$ 3,913,125	$ 2,959,807	$ 352,210	$ (4,007,562)	$ 3,217,580	$ 3,819,360	$ 3,131,088	$ 344,992	$ (3,96

LIABILITIES AND SHAREHOLDERS EQUITY

$ 35,170	$ 51,034	$ 5,881	$	$ 92,085	$ 27,377	$ 53,966	$ 5,349	$
22,236	173,736	9,366		205,338	31,541	279,662	9,789	
		3,647		3,647			3,662	
					85,550			
57,406	224,770	18,894		301,070	144,468	333,628	18,800	
346,576				346,576	339,016			
64,562	44,479	14,365		123,406	59,884	48,579	14,908	
998,053	(1,038,237)	40,184			906,685	(932,193)	25,508	
1,466,597	(768,988)	73,443		771,052	1,450,053	(549,986)	59,216	
2,446,528	3,728,795	278,767	(4,007,562)	2,446,528	2,369,307	3,681,074	285,776	(3,96
$ 3,913,125	$ 2,959,807	$ 352,210	$ (4,007,562)	$ 3,217,580	$ 3,819,360	$ 3,131,088	$ 344,992	$ (3,96

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

GUARANTOR SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS
(In thousands)
(Unaudited)

	Three Months Ended September 30, 2010					Three Months Ended September 30, 2009				
	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	King Consolidated	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	C
	$ 67,758	$ 305,452	$ 43,946	$ (76,936)	$ 340,220	$ 82,122	$ 417,659	$ 44,393	$ (92,757)	
	25,415	8,911			34,326		11,932			
es	93,173	314,363	43,946	(76,936)	374,546	82,122	429,591	44,393	(92,757)	
osts and										
nues	25,185	160,271	24,444	(77,249)	132,651	18,865	210,844	26,561	(93,473)	
eral and										
ve	46,316	61,590	7,582		115,488	51,790	76,525	7,427		
d										
t	3,422	21,443	801		25,666	1,270	22,613	(1,243)		
n and										
	4,621	27,249	809		32,679	4,622	47,873	854		
g charges	(26)	41			15	732	921			
ets held for										
		(677)			(677)					
ing costs										
s	79,518	269,917	33,636	(77,249)	305,822	77,279	358,776	33,599	(93,473)	
come										
	13,655	44,446	10,310	313	68,724	4,843	70,815	10,794	716	
e										
me	315	(53)	138		400	704	24	299		
ense	(6,858)	(385)	(50)		(7,293)	(21,407)	(749)	(62)		
ian®										
on										
	(2,476)				(2,476)	521				

y ent of									
	444	106	1,689		2,239	503	(939)	1,962	
rnings sidiaries	39,452	2,966	(13)	(42,405)		52,625	5,798	(100)	(58,323)
y interest ense)	(4,025)	13,181	(9,156)			(3,306)	12,791	(9,485)	
ncome	26,852	15,815	(7,392)	(42,405)	(7,130)	29,640	16,925	(7,386)	(58,323)
) before s	40,507	60,261	2,918	(42,092)	61,594	34,483	87,740	3,408	(57,607)
expense	1,287	19,878	1,209		22,374	(8,005)	30,788	2,753	
(loss)	$ 39,220	$ 40,383	$ 1,709	$ (42,092)	$ 39,220	$ 42,488	$ 56,952	$ 655	$ (57,607)

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

GUARANTOR SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS (Continued)
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2010					Nine Months Ended September 30, 200			
	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	King Consolidated	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminatio
	$ 235,754	$ 964,678	$ 127,645	$ (281,926)	$ 1,046,151	$ 260,897	$ 1,219,337	$ 114,232	$ (298,41
	51,032	29,121			80,153	(53)	41,399		
	286,786	993,799	127,645	(281,926)	1,126,304	260,844	1,260,736	114,232	(298,41
d									
	77,215	509,071	72,630	(280,184)	378,732	76,958	616,718	76,127	(299,97
d	145,440	218,681	23,671		387,792	157,662	222,845	21,133	
	8,326	75,650	3,188		87,164	3,864	64,775	2,459	
	16,322	124,933	2,602		143,857	14,272	142,582	2,706	
ges	2,730	2,399			5,129	15,039	36,139		
d for		(677)			(677)				
sts	250,033	930,057	102,091	(280,184)	1,001,997	267,795	1,083,059	102,425	(299,97
	36,753	63,742	25,554	(1,742)	124,307	(6,951)	177,677	11,807	1,55
	955	13	328		1,296	3,132	301	1,888	
	(21,377)	(1,985)	(146)		(23,508)	(69,875)	(2,826)	(212)	
		12,500			12,500				
	(3,099)				(3,099)	(826)			
	(2,252)				(2,252)				

392	(91)	(18)		283	544	1,008	1,307	
es 63,256	8,367	(40)	(71,583)		124,175	17,846	(60)	(141,96
rest (8,427)	31,877	(23,450)			(5,993)	22,264	(16,271)	
e 29,448	50,681	(23,326)	(71,583)	(14,780)	51,157	38,593	(13,348)	(141,96
re 66,201	114,423	2,228	(73,325)	109,527	44,206	216,270	(1,541)	(140,40
e 4,524	40,313	3,013		47,850	(25,495)	72,624	1,700	
$ 61,677	$ 74,110	$ (785)	$ (73,325)	$ 61,677	$ 69,701	$ 143,646	$ (3,241)	$ (140,40

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KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

GUARANTOR SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2010				Nine Months Ended September 30, 2009			
	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	King Consolidated	King	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	King Consolidated
Cash flows provided by operating activities	$ 44,538	$ 103,365	$ (8,279)	$ 139,624	$ (43,719)	$ 285,141	$ 20,742	$ 262,164
Cash flows from investing activities:								
Transfers to restricted cash	(13)			(13)	(42)	(27)		(69)
Proceeds from maturities and sales of investments in debt securities	95,895			95,895	38,473			38,473
Purchases of property, plant and equipment	(12,528)	(9,715)	(592)	(22,835)	(22,506)	(6,892)	(210)	(29,608)
Proceeds from sale of property and equipment	173	79		252	10	327		337
Proceeds from sale of Kadian®		47,500		47,500		59,800		59,800
Acquisition of Alpharma					(13,533)	(56,697)		(70,230)
Forward foreign exchange contracts							(8,906)	(8,906)
		(3,738)		(3,738)	(8)	(2,178)		(2,186)

Purchases of intellectual property and product rights								
Net cash provided by (used in) investing activities	83,527	34,126	(592)	117,061	2,394	(5,667)	(9,116)	(12,389)
Cash flows from financing activities:								
Proceeds from exercise of stock options	1,723			1,723	1,742			1,742
Net payments related to stock-based award activity	(5,003)			(5,003)	(3,554)			(3,554)
Payments on debt	(92,261)		(15)	(92,276)	(324,073)	(385,227)	(1,129)	(710,429)
Debt issuance costs	(4,621)			(4,621)	(1,313)			(1,313)
Intercompany	98,027	(112,617)	14,590		160,278	(137,491)	(22,787)	
Net cash (used in) provided by financing activities	(2,135)	(112,617)	14,575	(100,177)	(166,920)	(522,718)	(23,916)	(713,554)
Effect of exchange rate changes on cash			(4,300)	(4,300)			3,535	3,535
Increase (decrease) in cash and cash equivalents	125,930	24,874	1,404	152,208	(208,245)	(243,244)	(8,755)	(460,244)
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	$ 403,533	$ 55,653	$ 238,334	$ 697,520	$ 193,412	$ 46,752	$ 239,804	$ 479,968

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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 our business, financial condition and results of 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 Alpharma 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.

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The 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 Alpharma animal health products are sold primarily through distributors and other third-party sales companies.

Recent Developments

Pfizer Merger Agreement

On October 11, 2010, we entered into an agreement and plan of merger (the Merger Agreement) with Pfizer Inc. and a wholly owned subsidiary of Pfizer Inc. (together, Pfizer) pursuant to which Pfizer has agreed to commence a tender offer to purchase all of the outstanding shares of common stock, no par value per share, of King (the Shares) for $14.25 per Share net to the seller in cash (the Offer). Pfizer commenced the Offer on October 22, 2010. The Offer expires on November 19, 2010, unless extended in accordance with the terms of the Merger Agreement. Completion of the Offer is subject to customary conditions including, among others, (i) a majority of the Shares issued and outstanding (on a fully-diluted basis, without giving effect to compensatory equity awards that may be validly cancelled under the Merger Agreement upon completion of the Offer) being validly tendered and not validly withdrawn and (ii) the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, expiring and all other authorizations, consents, and approvals of or notices or filings with any foreign antitrust or competition regulatory authority having been made or obtained.

Subject to the terms and conditions of the Merger Agreement, we have granted Pfizer an irrevocable option (the Top-Up Option) to purchase an aggregate number of newly-issued shares of our common stock that, at the time of such exercise, and when added to the Shares owned by Pfizer and any of its subsidiaries constitutes one Share more than 90% of the Shares that would be outstanding immediately after the issuance of Shares pursuant to such exercise (on a fully diluted basis), subject to there being authorized Shares available for issuance. The Top-Up Option is exercisable only after Shares have been purchased by Pfizer pursuant to the Offer. The consideration for each Share acquired upon exercise of the Top-Up Option will be the Offer price.

The Merger Agreement prohibits us from soliciting or initiating discussions with third parties regarding other proposals to acquire us and we have agreed to restrictions on our ability to respond to such proposals, subject to certain exceptions. The Merger Agreement also contains customary termination provisions for us and Pfizer. Upon termination of the Merger Agreement, under specified circumstances we will be required to pay to Pfizer a termination fee of $110 million (or $75 million if the basis for the actions giving rise to such termination was King s receipt, within 30 days of the date of the Merger Agreement, of an alternative acquisition proposal that King s Board of Directors determines in good faith constitutes or could be reasonably expected to result in a superior proposal). In addition, the Merger Agreement contains representations, warranties and covenants of the parties customary for transactions of this type. Additionally, under certain circumstances, in addition to a termination fee, we would be required to reimburse Pfizer for its actual expenses incurred in connection with the proposed transaction, subject to a $15 million cap.

In connection with the Merger Agreement, in October 2010 the Board of Directors approved payments of awards under certain of our employee incentive award plans for the 2010 performance period, which will be recognized and paid in the fourth quarter of 2010. In addition, we expect to incur fees for our legal and financial advisors related to the merger with Pfizer. In the aggregate, the costs described in this paragraph are estimated to approximate $50 to $60 million.

Remoxy®

Remoxy® is a unique long-acting formulation of oral oxycodone with a proposed indication for the management of moderate to severe pain when a continuous, around-the-clock, opioid analgesic is needed for an extended period of time. This formulation uses the Oradur™ platform technology, which provides a unique physical barrier that is designed to provide controlled pain relief and at the same time resist certain common methods used to extract the opioid more rapidly than intended as can occur with products currently on the market that are abused in this way for non-medical purposes. Common methods used to cause a rapid extraction of an opioid include crushing, chewing and dissolution in alcohol. These methods are typically used to cause failure of the controlled

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release dosage form, resulting in dose dumping of oxycodone, or the immediate release of the active drug so as to achieve a state of euphoria.

We submitted the New Drug Application (NDA) for Remoxy® in June 2008. On December 10, 2008, we received a Complete Response Letter from the FDA with respect to the NDA for Remoxy®, requiring additional information to support approval. In early July 2009, we met with the FDA to discuss the Complete Response Letter. As part of the resubmission plan, and in order to strengthen the NDA, we undertook a likeability study and a pharmacokinetic trial in volunteers. We plan to resubmit the NDA late in the fourth quarter of 2010.

Acurox® Tablets (with niacin)

Acurox® 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® uses Acura Pharmaceuticals Inc. s (Acura) patented Aversion® 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® 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® 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® 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 NDA for Acurox® Tablets. The Complete Response Letter raises issues regarding the potential abuse deterrent benefits of Acurox®. 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. On April 22, 2010, the FDA held an advisory committee meeting to review the NDA related to Acurox®. The advisory committee voted that they did not have sufficient evidence to support the approval of the NDA for Acurox® Tablets for the treatment of moderate to severe pain. The presence of niacin in Acurox® 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® Tablets. We continue to evaluate our plans regarding the NDA.

Acurox® Tablets (without niacin)

Acura and King plan to develop and submit an NDA for Acurox® (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 original Acurox® Tablets formulation. The Companies expect to submit an NDA for Acurox® 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® Technology: Vycavert® (hydrocodone bitartrate/acetaminophen) Tablets and Acuracet® (oxycodone HCl/acetaminophen) Tablets. Like Acurox® 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.

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. In August 2010, the Court of Appeals for the Federal Circuit affirmed the actions of the District Court. Generic versions of Skelaxin® entered the market early in the second quarter of 2010, one of which is an authorized generic product sold by CorePharma, LLC (CorePharma) under a license from us. Net sales of Skelaxin® have declined significantly and will continue to decline as a result of generic competition. According to IMS America, Ltd. (IMS) weekly prescription data, for the week ending October 22, 2010, generic competitors have garnered approximately 85% of the prescriptions in the metaxalone market.

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

II. RESULTS OF OPERATIONS

Three and Nine Months Ended September 30, 2010 and 2009

Revenues

The following table summarizes total revenue by operating segment:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Total Revenues				
Branded prescription pharmaceuticals	$ 160,750	$ 283,414	$ 564,534	$ 836,228
Alpharma Animal Health	92,656	95,843	258,643	258,502
Meridian Auto-Injector	83,613	71,841	216,142	200,539
Royalties and other	37,527	12,251	86,985	42,125
Total revenues	$ 374,546	$ 463,349	$ 1,126,304	$ 1,337,394

The following table summarizes our deductions from gross revenues:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)			
Gross Revenues	$ 453,577	$ 548,854	$ 1,375,269	$ 1,578,731
Commercial Rebates	10,592	18,484	39,811	48,329
Medicare Part D Rebates	3,347	3,243	9,476	8,881
Medicaid Rebates	6,309	8,113	24,113	31,136
Chargebacks	30,084	28,155	87,712	83,035
Returns	10,253	5,926	30,740	14,154
Trade Discounts/Other	18,446	21,584	57,113	55,802
Total revenues	$ 374,546	$ 463,349	$ 1,126,304	$ 1,337,394

Gross revenues decreased in the third quarter of 2010 compared to the third quarter of 2009, and in the first nine months of 2010 compared to the first nine months of 2009, primarily due to decreased sales of Skelaxin® and market competition with several other key products in the branded prescription pharmaceuticals segment, partially offset by increased revenues in our Meridian Auto-Injector and Royalties and other segments discussed below.

Based on inventory data provided to us by our customers, we believe that wholesale inventory levels of Thrombin-JMI®, Flector® Patch, Avinza®, Embeda®, Levoxyl®, and Skelaxin® are at or below normalized levels as of September 30, 2010. As of September 30, 2010, we estimate that wholesale and retail inventories of our products represent gross sales of approximately $85.0 million to $95.0 million.

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

	2010	2009
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
Current provision related to sales made in current period	$ 21,027	$ 31,219
Current provision related to sales made in prior periods	1,491	(2,334)
Alpharma acquisition	99	885
Rebates paid	(30,575)	(35,474)
Balance at June 30, net of prepaid amounts	$ 37,411	$ 49,336
Current provision related to sales made in current period	21,253	$ 30,200
Current provision related to sales made in prior periods	(1,005)	(360)
Alpharma acquisition	(9)	886
Rebates paid	(21,166)	(41,124)
Balance at September 30, net of prepaid amounts	$ 36,484	$ 38,938

Rebates include commercial, Medicaid and Medicare rebates.

Accrual for Returns (in thousands):

	2010	2009
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
Current provision	9,730	$ 5,345
Actual returns	(9,073)	(6,062)
Ending balance at June 30	$ 32,030	$ 30,991
Current provision	10,253	$ 5,926
Actual returns	(12,846)	(7,743)

Ending balance at September 30	$ 29,437	$ 29,174

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Accrual for Chargebacks (in thousands):

	2010	2009
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
Current provision	29,406	$ 26,704
Actual chargebacks	(29,178)	(27,958)
Ending balance at June 30	$ 10,454	$ 9,643
Current provision	30,084	$ 28,155
Actual chargebacks	(29,513)	(28,041)
Ending balance at September 30	$ 11,025	$ 9,757

Branded Prescription Pharmaceuticals Segment

	For the Three Months Ended September 30		Change 2010 vs. 2009		For the Nine Months Ended September 30,		Change 2010 vs. 2009	
	2010	2009	$	%	2010	2009	$	%
	(In thousands)				(In thousands)			
Branded Prescription Pharmaceutical revenue:								
Skelaxin®	$ 6,781	$ 102,080	$ (95,299)	(93.4)%	$ 103,017	$ 304,857	$ (201,840)	(66.2)%
Thrombin-JMI®	32,155	43,409	(11,254)	(25.9)	106,042	139,310	(33,268)	(23.9)
Flector® Patch	42,427	40,397	2,030	5.0	111,219	95,794	15,425	16.1
Avinza®	27,281	30,774	(3,493)	(11.4)	75,218	98,646	(23,428)	(23.7)
Embeda®	10,219	11,230	(1,011)	(9.0)	33,935	11,230	22,705	>100
Levoxyl®	15,478	16,995	(1,517)	(8.9)	46,936	51,847	(4,911)	(9.5)
Other	26,409	38,529	(12,120)	(31.5)	88,167	134,544	(46,377)	(34.5)
Total revenue	$ 160,750	$ 283,414	$ (122,664)	(43.3)%	$ 564,534	$ 836,228	$ (271,694)	(32.5)%

Skelaxin®

Net sales of Skelaxin® decreased significantly in the third quarter and first nine months of 2010 from the third quarter and first nine months of 2009 primarily due to the entry of two competitors in the market early in the second quarter

of 2010 with generic substitutes for Skelaxin®. Total prescriptions for Skelaxin® decreased approximately 89.9% and 64.9% in the third quarter and first nine months of 2010, respectively, from the third quarter and first nine months of 2009, respectively, according to IMS monthly prescription data. As a result of generic competition, net sales of Skelaxin® will continue to decrease significantly in 2010 compared to 2009.

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

Thrombin-JMI®

Net sales of Thrombin-JMI® decreased in the third quarter and first nine months of 2010 compared to the third quarter and first nine months 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® product to decrease in 2010 compared to 2009 as a result of competition.

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Flector® Patch

Net sales of Flector® Patch increased in the third quarter of 2010 from the third quarter of 2009 primarily due to an increase in wholesale inventory levels in the third quarter of 2010 and a price increase taken in the first quarter of 2010, partially offset by a decrease in prescriptions. Net sales of Flector® Patch increased in the first nine months of 2010 from the first nine months 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 8.3% and 6.9% in the third quarter and first nine months of 2010, respectively, compared to the third quarter and first nine months of 2009, respectively, according to IMS monthly prescription data. We anticipate lower net sales of Flector® Patch during the fourth quarter of 2010 compared to the fourth quarter of 2009.

Avinza®

Net sales of Avinza® decreased in the third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009, primarily due to a decrease in prescriptions, partially offset by a price increase taken in the fourth quarter of 2009. Total prescriptions for Avinza® decreased approximately 30.7% and 29.1% in the third quarter and first nine months of 2010, respectively, compared to the third quarter and first nine months of 2009, respectively, according to IMS monthly prescription data. We expect net sales of Avinza® to decrease in 2010 compared to 2009.

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

Embeda®

In August 2009, the FDA approved Embeda® (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® in late September 2009, and we anticipate net sales of Embeda® will increase significantly in 2010 compared to 2009. 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®. The letter indicated these materials were false or misleading because they omitted and minimized the risks associated with the use of Embeda®, 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® 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®. In late March 2010, we received DDMAC s reply to our submission and, during the third quarter of 2010, we began

using modified materials which are responsive to its comments.

On March 23, 2010 and April 30, 2010, we voluntarily recalled certain lots of Embeda® as a result of issues noted in standard post-manufacturing testing that were not related to patient safety. We believe the recalls caused some disruption in the market that could have negatively affected the prescriptions of Embeda®. The recalls did not have a significant effect on the results of operations during the first or second quarters of 2010. During the third

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quarter of 2010, we increased our estimated reserve for these recalls and decreased net sales of Embeda® by approximately $2.9 million. During the fourth quarter of 2010, we voluntarily recalled two lots of Embeda® from our wholesale customers as a result of issues noted in post-manufacturing testing that were not related to product safety. The fourth quarter of 2010 recall did not have a significant effect on our results of operations.

Levoxyl®

Net sales of Levoxyl® decreased in the third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009, primarily due to a decrease in prescriptions. Total prescriptions for Levoxyl® decreased approximately 17.5% and 13.4% in the third quarter and first nine months of 2010, respectively, compared to the third quarter and first nine months of 2009, according to IMS monthly prescription data. We anticipate net sales for this product will continue to decline in the fourth quarter of 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 third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009 primarily due to lower net sales of Cytomel®, increases in returns of certain products, and a decrease in prescriptions.

In April 2009, a third party entered the market with a generic substitute for Cytomel®. As a result of the entry of generic competition, net sales of Cytomel® declined in the third quarter of 2010 and we expect net sales of Cytomel® to continue to decline in the future. Net sales of Cytomel® decreased from $6.6 million and $27.9 million in the third quarter and first nine months of 2009, respectively, to $4.4 million and $14.2 million in the third quarter and first nine months of 2010, respectively.

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 the fourth quarter of 2010.

Alpharma Animal Health

Revenues of the Alpharma animal health segment were consistent in the third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009.

Meridian Auto-Injector

Revenues from our Meridian Auto-Injector segment increased in the third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009, primarily due to price increases and higher unit sales of EpiPen®, partially offset by lower sales 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 3.6% and 6.3% in the third quarter and first nine months of 2010, respectively, compared to the third quarter and first nine months of 2009, according to IMS monthly prescription data.

During the second quarter of 2010, we entered into a new supply agreement with Dey, L.P. with a term through December 31, 2020.

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Royalties and other

Skelaxin® Authorized Generic

During the third quarter and first nine months of 2010, we recognized revenue of $25.2 million and $50.8 million, respectively, related to our agreement with CorePharma, under which we provide it with a license to launch an authorized generic version of Skelaxin® under certain conditions. In accordance with this agreement, we receive a fee based on gross profit, as defined in the agreement, of the authorized generic product. CorePharma began selling the authorized generic version of Skelaxin® early in the second quarter of 2010.

Adenoscan®

We receive royalty revenue 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®. During the second quarter of 2010, we recorded royalty revenue related to Adenoscan of $2.8 million as a result of the minimum royalty agreement we have with Astellas US for the contract year ended May 30, 2010.

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

	For the Three Months Ended September 30,		Change 2010 vs. 2009		For the Nine Months Ended September 30,		Change 2010 vs. 2009	
	2010	2009	$	%	2010	2009	$	%
	(In thousands)				(In thousands)			
Cost of revenues, exclusive of depreciation and amortization shown below	$ 132,651	$ 162,797	$ (30,146)	(18.5)%	$ 378,732	$ 469,829	$ (91,097)	(19.4)%
Selling, general and administrative	115,488	135,742	(20,254)	(14.9)	387,792	401,640	(13,848)	(3.4)
Research and development	25,666	22,640	3,026	13.4	87,164	71,098	16,066	22.6
	32,679	53,349	(20,670)	(38.7)	143,857	159,560	(15,703)	(9.8)

Depreciation and amortization								
Restructuring charges	15	1,653	(1,638)	(99.1)	5,129	51,178	(46,049)	(90.0)
Gain on asset held for sale	(677)		(677)		(677)		(677)	
Total operating costs and expenses	$ 305,822	$ 376,181	$ (70,359)	(18.7)%	$ 1,001,997	$ 1,153,305	$ (151,308)	(13.1)%

Cost of Revenues

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

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,

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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; 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 Alpharma, 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® Patch and Alpharma animal health inventory by approximately $42.1 million. During the third quarter and first nine months of 2009, the cost of revenues reflects a charge of $2.6 million and $40.2 million, respectively, related to the sale of this marked up inventory.

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

Selling, General and Administrative Expenses

	For the Three Months Ended September 30,		Change 2010 vs. 2009		For the Nine Months Ended September 30,		Change 2010 vs. 2009	
	2010	2009	$	%	2010	2009	$	%
	(In thousands)				(In thousands)			
Selling, general and administrative	$ 114,341	$ 135,742	$ (21,401)	(15.8)%	$ 386,645	$ 394,907	$ (8,262)	(2.1)%
Merger and acquisition related costs	1,147		1,147		1,147	6,733	(5,586)	(83.0)
Total selling, general and administrative	$ 115,488	$ 135,742	$ (20,254)	(14.9)%	$ 387,792	$ 401,640	$ (13,848)	(3.4)%

As a percentage of total revenues, total selling, general, and administrative expenses were 30.8% and 34.4% in the third quarter and first nine months of 2010, respectively. As a percentage of total revenues, total selling, general and administrative expenses were 29.3% and 30.0% in the third quarter and first nine months of 2009, respectively.

Total selling, general and administrative expenses decreased in the third quarter of 2010 compared to the third quarter of 2009, primarily due to a decrease in marketing due to the launch of Embeda® in the third quarter of 2009. In addition, total selling, general and administrative expenses decreased in the first nine months of 2010 compared to the first nine months of 2009 due to a decrease in expenses resulting from the integration of Alpharma and a restructuring initiative related to Skelaxin®.

Alpharma was purchased on December 29, 2008. The integration of Alpharma 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 Alpharma corporate and pharmaceutical management division employees and related activities.

Following the January 2009 court order ruling invalid two patents relating to Skelaxin®, 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 special charges of $6.7 million in the first nine months of 2009 for costs related to the acquisition and integration of Alpharma. We incurred charges of $1.1 million in the third quarter of 2010 for costs related to the Pfizer merger. In addition, we incurred net special charges of $3.5 million in the first nine months of 2010 related to litigation settlements.

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Research and Development Expense

	For the Three Months Ended September 30,		Change 2010 vs. 2009		For the Nine Months Ended September 30,		Change 2010 vs. 2009	
	2010	2009	$	%	2010	2009	$	%
	(In thousands)				(In thousands)			
Research and development	$ 25,666	$ 22,640	$ 3,026	13.4%	$ 87,164	$ 71,098	$ 16,066	22.6%

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 in the third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009 due to the timing of costs incurred on our current research and development projects. During the second quarter of 2010, we incurred a $5.0 million expense associated with the modification of our strategic alliance with Pain Therapeutics, Inc. (Pain Therapeutics) for Remoxy® and other opioid products. During the second quarter of 2010, we modified the strategic alliance with Pain Therapeutics to provide a royalty rate of 10% of net sales outside the U.S. The original agreement called for a royalty rate of 15% of net sales and included a provision to increase the royalty rate to 20% should certain net sales benchmarks be met. We also gained certain rights to the development of other opioid products covered by the collaboration agreement. The U.S. royalty rate and potential milestone payments under the strategic alliance with Pain Therapeutics remain unchanged.

For a discussion regarding recent research and development activities, please see Recent Developments above.

Depreciation and Amortization Expense

Skelaxin® was completely amortized during the second quarter of 2010. As a result, amortization expense decreased significantly in the third quarter of 2010 compared to the third quarter of 2009. The amortization expense associated with Skelaxin® in the third quarter and first nine months of 2009 was $20.0 million and $60.1 million, respectively. The amortization expense associated with Skelaxin® in the first nine months of 2010 was $43.2 million.

Depreciation and amortization expense in the first nine months of 2009 includes special items of $1.3 million due to accelerated depreciation on certain assets.

Certain manufacturers of generic pharmaceutical products have challenged the patents covering Avinza® and EpiPen®. For additional information, please see Note 9, Commitments and Contingencies , in Part I, Item 1, Financial Statements. If a generic version of Avinza® or EpiPen® 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 these products.

Other Operating Expenses

We incurred restructuring charges of $5.1 million in the first nine months of 2010, primarily due to a restructuring of our commercial operations organization in the second quarter of 2010.

We incurred restructuring charges of $1.7 million and $51.2 million in the third quarter and first nine months of 2009, respectively, primarily due to our restructuring initiative related to Skelaxin®.

For additional information on restructuring events, please see Note 13, Restructuring Activities , in Part I, Item 1, Financial Statements.

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Non-Operating Items

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(In thousands)		(In thousands)	
Interest income	$ 400	$ 1,027	$ 1,296	$ 5,321
Interest expense	(7,293)	(22,218)	(23,508)	(72,913)
Gain on Kadian®			12,500	
(Loss) gain on investments	(2,476)	521	(3,099)	(826)
Loss on early extinguishment of debt			(2,252)	
Other, net	2,239	1,526	283	2,859
Total other income (expense)	$ (7,130)	$ (19,144)	$ (14,780)	$ (65,559)
Income tax expense	$ 22,374	$ 25,536	$ 47,850	$ 48,829

Interest Income

Interest income decreased during the third quarter and first nine months of 2010 compared to the third quarter and first nine months of 2009, primarily due to a lower average balance of investments in debt securities 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, cash received through redemptions of our auction rate securities of approximately $145.9 million during 2009 and the first quarter of 2010 was used to reduce long-term debt.

Interest Expense

Interest expense decreased in the third quarter and first nine months of 2010 compared to the third quarter and first nine months 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 our Senior Secured Revolving Credit Facility (the 2008 Revolving Credit Facility) entered into April 19, 2007 and amended December 5, 2008, 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 2008 Revolving Credit Facility, and $385.2 million related to the Alpharma Convertible Senior Notes. In addition, during the first quarter of 2010, the remaining outstanding borrowings of $92.3 million under the 2008 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, which is reflected as an increase in interest expense. Interest expense in the third quarter of 2010 and 2009 reflects non-cash interest of $4.8 million and $4.5 million, respectively, and $14.3 million and $13.3 million in the first nine months of 2010 and 2009, respectively, due to the accretion of the debt component of the Convertible Senior Notes.

During the second quarter of 2010, we recorded a gain of $12.5 million as a result of the divestiture of Kadian®. For additional information regarding the Kadian® divestiture, please see Kadian® within the Liquidity and Capital Resources section below.

A loss of $2.5 million and a gain of $0.5 million in the third quarter of 2010 and 2009, respectively, and a loss of $3.1 million and $0.8 million in the first nine months of 2010 and 2009, respectively, related to our investments in debt securities.

A loss of $2.3 million in the second quarter of 2010 resulting from the early termination of our 2008 Revolving Credit Facility. On May 11, 2010, we entered into a new $500.0 million five-year Senior Secured Revolving Credit Facility (2010 Revolving Credit Facility) with Credit Suisse AG, as Administrative

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Agent (the Administrative Agent) and terminated the 2008 Revolving Credit Facility that was scheduled to mature April 2012. As a result, we wrote off a portion of the deferred financing costs associated with the 2008 Revolving Credit Facility.

Income Tax Expense

During the third quarter and first nine months of 2010, our effective income tax rate was 36.3% and 43.7%, respectively. During the third quarter and first nine months of 2009, our effective income tax rate was 37.5% and 41.2%, respectively. These rates are greater than the statutory rate of 35% primarily due to losses from foreign subsidiaries with no tax benefit, taxes related to stock compensation and 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.

Investments in Debt Securities

As of September 30, 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 7, 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 September 30, 2010, all our investments in auction rate securities, with a total par value of $185.0 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 November 2, 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 $170.0 million in par value of our investments in debt securities, or 19.9% 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.

As of September 30, 2010, there were cumulative unrealized holding losses of $21.4 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 $170.0 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 September 30, 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 third quarter of 2010, we sold an auction rate security associated with student loans with a par value of $0.5 million to the issuer at a discount of 3% and realized an insignificant loss in the Condensed Consolidated Statements of Operations. 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. During the second quarter of 2009, we sold certain auction rate securities associated with student loans with a par value of $20.4 million for $18.9 million to the issuer and realized

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a loss of $1.4 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). During the second quarter of 2010, we notified UBS of our intent to sell the auction rate securities related to this offer. During the third quarter of 2010, we sold the auction rate securities that were included in the UBS right for par value of $18.2 million. We did not recognize any gain or loss on the exercise of the right and the sale of the securities. At December 31, 2009, we held auction rate securities related to this offer with a par value of $32.5 million. We elected the fair value option to account for this right. As a result, gains and losses associated with this right were 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 December 31, 2009, the fair value of the right to sell the auction rate securities to UBS at par was $3.2 million. With respect to this right, we recognized unrealized losses of $1.9 million and $3.2 million during the third quarter and first nine months of 2010, respectively, and an unrealized loss of $0.4 million during the first nine months 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 December 31, 2009, the fair value of the investments in debt securities classified as trading was $29.3 million. We recognized unrealized gains related to these securities of $1.9 million and $3.2 million during the third quarter and first nine months of 2010, respectively, and $0.5 million and $1.0 million during the third quarter and first nine months of 2009, respectively, in Other income (expense) in the accompanying Condensed Consolidated Statements of Operations.

During the third quarter of 2010, we recognized $2.5 million of additional other-than-temporary credit losses related to a municipal bond that had been previously impaired.

As of September 30, 2010, we had approximately $185.0 million, in par value, invested in tax-exempt auction rate securities which consisted of $85.9 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 $11.5 million associated with student loans collateralized by loan pools that equal at least 200% of the bond issue.

As of September 30, 2010, we classified all of our auction rate securities as long-term assets.

Skelaxin®

In January 2009, the U.S. District Court for the Eastern District of New York issued an order ruling invalid two patents relating to our product Skelaxin®. In June 2009, the Court entered judgment against us. In August 2010, the Court of Appeals for the Federal Circuit affirmed the actions of the District Court. Generic versions of Skelaxin® entered the market early in the second quarter of 2010. Net sales of Skelaxin® have declined significantly and are expected to continue to decline 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.

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.

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Kadian®

In connection with the acquisition of Alpharma, we and Alpharma 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 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, we divested the Kadian® product to Actavis LLC. Actavis LLC is entitled to sell Kadian® as a branded or generic product. Prior to this divestiture, Actavis LLC supplied Kadian® to Alpharma.

Actavis LLC paid a purchase price of $127.5 million 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 purchase price payment associated with each calendar quarter is as follows:

	Purchase Price Payment
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

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. We recorded a gain of $12.5 million in the second quarter of 2010 as a result of the divestiture. In accordance with the agreement, quarterly payments were received one quarter in arrears. During the third quarter and first nine months of 2010, we received $7.5 million and $47.5 million, respectively, from Actavis LLC related to gross profit from sales during the fourth quarter of 2009 and the first six months of 2010.

Alpharma

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

We estimated total costs of approximately $70.7 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 end 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 Alpharma outstanding at the time of the acquisition and at December 31, 2008. For additional information, please see Alpharma Convertible Senior Notes in Note 8, Long-Term Debt , in Part I, Item 1, Financial Statements.

Senior Secured Revolving Credit Facility

On May 11, 2010, we entered into the $500.0 million 2010 Revolving Credit Facility and terminated the existing $475.0 million 2008 Revolving Credit Facility, which was scheduled to mature in April 2012. The 2010 Revolving Credit Facility matures on May 11, 2015.

In connection with the acquisition of Alpharma on December 29, 2008, we borrowed $425.0 million in principal amount under the 2008 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 2008 Revolving Credit Facility, $203.2 million in excess of the required amounts, which represented full payment of all borrowings under the 2008 Revolving Credit Facility.

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As of September 30, 2010, the remaining undrawn commitment amount under the 2010 Revolving Credit Facility totals approximately $496.3 million after giving effect to outstanding letters of credit totaling approximately $3.7 million.

For additional discussion regarding the 2010 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 Aversion® 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 Aversion® Technology. In addition, the agreement provides us with an option to license all future opioid analgesic products developed utilizing Acura s Aversion® 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® 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 clinical and regulatory milestones for Acurox® 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® 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®

In September 2006, we entered into a definitive asset purchase agreement and related agreements with Ligand Pharmaceuticals Incorporated (Ligand) to acquire rights to Avinza® (morphine sulfate long-acting). Avinza® 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 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® until October 2008. Subsequent royalty payments to Ligand are based upon calendar year net sales of Avinza® 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.

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Embeda®

On July 23, 2010, King and Alpharma (collectively the King Parties) entered into a settlement agreement with Purdue Pharma L.P. (Purdue). Pursuant to the terms of the agreement, Purdue agreed not to sue the King Parties or their affiliates in the United States with regard to the manufacture, use or sale of Embeda®. The King Parties paid to Purdue an up-front payment in the third quarter of 2010 and are obligated to pay a quarterly royalty on net sales of Embeda® for the duration of any valid claims in the 088 and 939 patents, or other patents in the same family that cover the Embeda® product. In addition, the King Parties agreed not to challenge certain of Purdue s patents including the 088 and 939 patents, as they may relate to Embeda®.

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. For the full year of 2010, we expect rebates to increase by approximately $6.0 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® 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 paid Allerex an earn-out equal to a percentage of future sales of EpiPen® in Canada over a fixed period of time, which concluded as of September 30, 2010. As these additional payments accrued, we increased intangible assets by the amount of the accrual. As of September 30, 2010, we incurred a total of $14.2 million for these earn-out payments.

In December 2005, we entered into a cross-license agreement with Mutual related to Skelaxin®. 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®.

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. During the second quarter of 2010, we incurred a $5.0 million expense associated with the modification of our strategic alliance with Pain Therapeutics for Remoxy® and other opioid painkillers which was paid in the third quarter of 2010. The modification reduced the royalty rate on net sales of Remoxy® and other products developed through this alliance for net sales outside the U.S to 10%. We also gained certain rights to the development of other opioid products covered by the collaboration

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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 in the U.S. up to $1.0 billion and 20% of the cumulative net sales in the U.S. over $1.0 billion. We are responsible for research and development expenses related to this alliance, subject to certain limitations set forth in the agreement.

Patent Challenges

Certain generic companies have challenged patents on Avinza® and EpiPen®. For additional information, please see Note 9, Commitments and Contingencies, in Part I, Item 1, Financial Statements. 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

	For the Nine Months Ended September 30,	
	2010	2009
	(In thousands)	
Net cash provided by operating activities	$ 139,624	$ 262,164

Our net cash from operations was lower in the first nine months of 2010 than in the first nine months 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.

In March 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 nine months of 2009 and 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.

The following table summarizes the changes in operating assets and liabilities and deferred taxes for the nine months ended September 30, 2010 and 2009:

	For the Nine Months Ended September 30,	
	2010	2009
	(In thousands)	
Accounts receivable, net of allowance	$ (7,145)	$ 17,672
Inventories	(17,213)	11,495
Prepaid expenses and other current assets	691	(11,908)
Accounts payable	7,640	(53,472)

Accrued expenses and other liabilities	(113,012)	(81,352)
Income taxes payable	6,823	(18,141)
Deferred revenue	(3,510)	(3,510)
Other assets	(1,130)	9,835
Deferred taxes	29,849	41,460
Total changes in operating assets and liabilities and deferred taxes	$ (97,007)	$ (87,921)

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Investing Activities

	For the Nine Months Ended September 30,	
	2010	2009
	(In thousands)	
Net cash provided by (used in) investing activities	$ 117,061	$ (12,389)

Our cash flows from investing activities for 2010 were primarily due to net sales of our investments in debt securities of $95.9 million and proceeds related to the sale of Kadian® of $47.5 million, partially offset by capital expenditures of $22.8 million. Our cash flows from investing activities for 2009 were primarily due to payments made in connection with our acquisition of Alpharma of $70.2 million and capital expenditures of $29.6 million, partially offset by proceeds related to the sale of Kadian® of $59.8 million and proceeds from the sale of debt securities of $38.5 million.

We anticipate capital expenditures, including capital lease obligations, for the year ending December 31, 2010 of approximately $30.0 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

	For the Nine Months Ended September 30,	
	2010	2009
	(In thousands)	
Net cash used in financing activities	$ (100,177)	$ (713,554)

Our cash flows from financing activities for the first nine months of 2010 are primarily related to payments on long-term debt. During the first quarter of 2010, we made payments of $92.3 million on the 2008 Revolving Credit Facility, which represented full payment of all outstanding borrowings. During the first nine months of 2009, we made payments on debt of $710.4 million, which included $385.2 million to redeem the Alpharma Convertible Senior Notes, $152.8 million on the 2008 Revolving Credit Facility and $171.3 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 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

The 2010 Revolving Credit Facility provides us with aggregate revolving credit commitments of $500.0 million, with a $50.0 million sublimit for the issuance of letters of credit. The 2010 Revolving Credit Facility also provides for

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an incremental term loan facility in an aggregate amount of up to $500.0 million. The 2010 Revolving Credit Facility matures on May 11, 2015.

As of September 30, 2010, there were no outstanding borrowings under the 2010 Revolving Credit Facility and letters of credit totaled $3.7 million. The undrawn commitment amount under the 2010 Revolving Credit Facility on September 30, 2010 totals $496.3 million after giving effect to letters of credit.

In connection with our acquisition of Alpharma on December 29, 2008, we borrowed $425.0 million in principal under the 2008 Revolving Credit Facility. Prior to the termination of the 2008 Revolving Credit Facility, we made payments of $92.3 million on this facility in the first quarter of 2010, which represented full payment on all outstanding borrowings under the facility. During the three and nine months ended September 30, 2009, we made payments of $18.6 million and $152.8 million, respectively, on the 2008 Revolving Credit Facility.

In connection with the establishment of the 2010 Revolving Credit Facility, we incurred approximately $4.6 million of new deferred financing costs. During the second quarter of 2010, we expensed $2.3 million of the $4.3 million of deferred financing costs that remained outstanding at the time of the termination of the 2008 Revolving Credit Facility. Therefore, deferred financing costs associated with the 2010 Revolving Credit Facility total $6.7 million and are being amortized over five years.

Our borrowings under the 2010 Revolving Credit Facility will bear interest at annual rates that, at our option, will be either:

a base rate generally defined as the sum of (i) the greatest of (a) the prime rate of the Administrative Agent, (b) the federal funds effective rate plus 0.5% and (c) the one-month adjusted London Interbank Offered (LIBO) rate (by reference to the British Bankers Association Interest Settlement Rates for deposits in dollars) plus 1.0% and (ii) an applicable percentage of 1.50%, 1.75% or 2.00%, depending on our corporate credit rating; or

an adjusted LIBO rate generally defined as the sum of (i) the product of (a) the LIBO rate (by reference to the British Bankers Association Interest Settlement Rates for deposits in dollars) in effect for the relevant interest period and (b) a fraction, the numerator of which is one and the denominator of which is one minus certain maximum statutory reserves for eurocurrency liabilities and (ii) an applicable percentage of 2.50%, 2.75% or 3.00%, depending on the our corporate credit rating.

If we make any borrowings under the incremental term loan facility, those borrowings will bear interest at annual rates established at the time of such borrowings.

We are required to pay an unused commitment fee on the difference between committed amounts and amounts actually borrowed under the 2010 Revolving Credit Facility equal to an applicable percentage of 0.375% or 0.5% per annum, depending on our corporate credit rating. We are required to pay a letter of credit participation fee based upon the aggregate face amount of outstanding letters of credit equal to an applicable percentage of 2.5%, 2.75% or 3.0% per annum, depending on our corporate credit rating.

The 2010 Revolving Credit Facility contains customary representations and warranties and affirmative covenants. The 2010 Revolving Credit Facility also contains certain covenants that restrict, among other things, our and our subsidiaries ability to incur additional indebtedness, permit certain liens to exist on assets, enter into sale and leaseback transactions, make investments, loans and advances, undertake acquisitions, mergers and consolidations, sell assets, make dividend and other restricted payments, enter into transactions with affiliates, prepay, redeem or repurchase other indebtedness and make capital expenditures, in each case, subject to certain exceptions.

The 2010 Revolving Credit Facility also requires us to meet the following financial tests:

- maintenance of a minimum consolidated EBITDA to consolidated interest expense ratio for periods of four consecutive fiscal quarters of 3.50 to 1; and

- maintenance of a maximum total funded debt to consolidated EBITDA ratio of 3.0 to 1.

As of September 30, 2010, we were in compliance with these covenants.

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The 2010 Revolving Credit Facility also contains customary events of default, including events of default based on failures to make payments as and when required under the 2010 Revolving Credit Facility, breaches of representations, warranties and covenants, defaults under certain other material indebtedness, the occurrence of certain bankruptcy and insolvency events related to us and certain of our subsidiaries, the levy of judgments in excess of specified amounts, the occurrence of certain ERISA events, certain impairments to the guarantees of our obligations under the credit facility, certain impairments of the security interests granted by us and the subsidiary guarantors in connection with the 2010 Revolving Credit Facility and a change in control of us.

Our obligations under the 2010 Revolving Credit Facility are guaranteed by each of our domestic subsidiaries and secured by pledges by us of certain of our assets, including equity interests in certain of our subsidiaries and intellectual property.

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 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.

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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 September 30, 2010 are as follows:

	Gross Carrying Amount	Accumulated Amortization (In thousands)	Net Book Value
Branded Prescription Pharmaceuticals			
Avinza®	$ 291,140	$ 95,962	$ 195,178
Skelaxin®	288,049	288,049	
Sonata®	61,961	61,961	
Flector® Patch	130,000	20,682	109,318
Neuroscience	771,150	466,654	304,496
Synercid®	70,959	52,214	18,745
Other hospital	8,442	6,960	1,482
Hospital	79,401	59,174	20,227
Bicillin®	92,350	37,748	54,602
Other legacy products	324,035	284,826	39,209
Legacy products	416,385	322,574	93,811
Total Branded	1,266,936	848,402	418,534
Alpharma Animal Health	170,083	16,852	153,231
Meridian Auto-Injector	187,536	56,279	131,257

Royalties and other	3,731	3,543	188
Total intangible assets	$ 1,628,286	$ 925,076	$ 703,210

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The amounts of impairments and amortization expense for the three months ended September 30, 2010 and 2009 are as follows:

	Three Months Ended September 30, 2010		Three Months Ended September 30, 2009	
	Impairments	Amortization Expense	Impairments	Amortization Expense
	(In thousands)		(In thousands)	
Branded Prescription Pharmaceuticals				
Avinza®	$	$ 6,808	$	$ 6,639
Skelaxin®				20,041
Flector® Patch		2,955		2,954
Neuroscience		9,763		29,634
Synercid®		1,441		1,485
Other hospital		77		76
Hospital		1,518		1,561
Bicillin®		925		925
Other legacy products		1,430		1,430
Legacy products		2,355		2,355
Total Branded		13,636		33,550
Alpharma Animal Health		2,406		2,348
Meridian Auto-Injector		2,282		2,102
Royalties and other		11		11
Total	$	$ 18,335	$	$ 38,011

The amounts of impairments and amortization expense for the nine months ended September 30, 2010 and 2009 are as follows:

	Nine Months Ended September 30, 2010		Nine Months Ended September 30, 2009	
	Impairments	Amortization Expense	Impairments	Amortization Expense
	(In thousands)		(In thousands)	
Branded Prescription Pharmaceuticals				
Avinza®	$	$ 20,365	$	$ 19,915
Skelaxin®		43,226		60,123

Flector® Patch		8,864		8,864
Neuroscience		72,455		88,902
Synercid®		4,326		4,453
Other hospital		228		228
Hospital		4,554		4,681
Bicillin®		2,776		2,775
Other legacy products		4,290		4,290
Legacy products		7,066		7,065
Total Branded		84,075		100,648
Alpharma Animal Health		7,219		7,167
Meridian Auto-Injector		6,658		6,199
Royalties and other		33		324
Total	$	$ 97,985	$	$ 114,338

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	Remaining Life at September 30, 2010
Skelaxin®	
Avinza®	7 years 2 months
Synercid®	3 years 3 months
Bicillin®	14 years 9 months
Flector® Patch	9 years 3 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, and 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.

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 7, 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

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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 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 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 or gross margin (namely, contractually agreed-upon royalty rates) reported by third parties.

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®, Avinza® and EpiPen® patent challenges and 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®, Avinza®, EpiPen® and Adenoscan®;

the potential of, including anticipated net sales and prescription trends for, our branded prescription pharmaceutical products, particularly Skelaxin®, Avinza®, Thrombin-JMI®, Flector® Patch, Embeda®, Levoxyl® and Cytomel®;

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;

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the development, approval and successful commercialization of Remoxy®, Acurox® Tablets, CorVue™ 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;

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; and

timing and expectations with respect to our proposed merger with Pfizer.

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, the effect of interest rate changes and the effect of changes in foreign currency exchange rates. At September 30, 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 (i) we fully repaid all borrowings under the 2008 Revolving Credit Facility in the first quarter of 2010, which carried a variable rate of interest, and (ii) we terminated the 2008 Revolving Credit Facility and entered into the 2010 Revolving Credit Facility in the second quarter of 2010. For additional information, please see Senior Secured Revolving Credit Facility within Certain Indebtedness and Other Matters , in Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations.

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 Securities and Exchange Commission.

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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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.

Our proposed transaction with Pfizer may cause disruption in our business and, if the proposed transaction does not occur, we will have incurred significant expenses, may need to pay a termination fee under the Merger Agreement and our stock price may decline.

On October 11, 2010, we entered into the Merger Agreement with Pfizer, pursuant to which Pfizer agreed to commence a tender offer to purchase all of the outstanding shares of our common stock (see Note 15, Subsequent Event , in Part I, Item 1, Financial Statements).

The announcement of the proposed transaction, whether or not consummated, may result in a loss of key personnel and may disrupt our sales and marketing, research and development, operational initiatives or other key business activities, which may have an impact on our financial performance. The Merger Agreement generally requires us to operate our business in the ordinary course pending consummation of the proposed transaction, but includes certain contractual restrictions on the conduct of our business that may affect our ability to execute on our business strategies and attain our financial goals. Additionally, the announcement of the proposed transaction, whether or not consummated, may impact our relationships with third parties, including collaboration partners, suppliers, distributors, consumers and others. We expect that matters relating to the proposed transaction (including integration planning) will require that our management and employees commit substantial amounts of time and that we commit significant resources, which could otherwise have been devoted to other business opportunities.

Since the announcement of the proposed transaction, a number of putative class action lawsuits have been filed by purported shareholders of the Company on behalf of themselves and other shareholders of the Company in relation to the transaction (see Note 9, Commitments and Contingencies , in Part I, Item 1, Financial Statements). Certain of these actions seek orders enjoining the proposed transaction or rescission of the transaction if it is consummated. We also could be subject to additional litigation related to the proposed transaction, whether or not it is consummated. While we currently believe all such litigation is without merit and will not succeed, these matters create additional uncertainty relating to the proposed transaction and defending the matters is costly and distracting to management.

If the Merger Agreement is terminated, under certain specified circumstances we will be required to pay Pfizer a termination fee of $110 million (or $75 million if the basis for the actions giving rise to such termination was King s receipt, within 30 days of the date of the Merger Agreement, of an alternative acquisition proposal that King s Board of Directors determines in good faith constitutes or could be reasonably expected to result in, a superior proposal). Additionally, under certain circumstances, in addition to a termination fee, we would be required to reimburse Pfizer for its actual expenses incurred in connection with the proposed transaction, subject to a $15 million cap.

The completion of the proposed transaction is subject to certain conditions, including, among others, (i) a majority of the shares of our common stock issued and outstanding (on a fully diluted basis, without giving effect to

compensatory equity awards that may be validly canceled under the Merger Agreement upon the completion of the tender offer) being validly tendered and not validly withdrawn and (ii) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and making or obtaining all other authorizations, consents and approvals of or notices or filings with any foreign antitrust or competition regulatory authority. We cannot predict whether the closing conditions for the proposed transaction set forth in the Merger Agreement will be satisfied. As a result, we cannot assure you that the proposed transaction will be completed. If the closing conditions for the proposed transaction are not satisfied or waived

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pursuant to the Merger Agreement, or if the transaction is not completed for any other reason, the market price of our common stock may decline significantly.

In addition, if the proposed transaction does not occur, we will nonetheless remain liable for the significant expenses that we have incurred related to the transaction. In connection with the Merger Agreement, in October 2010 the Board of Directors approved payments of awards under certain of our employee incentive award plans for the 2010 performance period, which will be recognized and paid in the fourth quarter of 2010. In addition, we expect to incur fees for our legal and financial advisors related to the merger with Pfizer. In the aggregate, the costs described in this paragraph are estimated to approximate $50 to $60 million.

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, and the Court entered judgment against the Company in June 2009. In August 2010, the Court of Appeals for the Federal Circuit affirmed the actions of the District Court. Generic versions of Skelaxin® entered the market early in the second quarter of 2010, including an authorized generic sold by CorePharma. The Company s net sales of Skelaxin® have declined significantly and will continue to decline as a result of this competition from generic products.

Item 6. ***Exhibits***

Exhibit Number	Description
10.1*	Settlement Agreement, dated July 23, 2010, by and among Purdue Pharma L.P., King Pharmaceuticals, Inc. and Alpharma Inc.
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
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

* Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request under Rule 24b-2 of the Securities Exchange Act of 1934, as amended.

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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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: November 5, 2010

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

Date: November 5, 2010