KING PHARMACEUTICALS INC
Form 10-K
March 03, 2006

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

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 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, Tennessee** (Address of Principal Executive Offices)	**37620** (Zip Code)

Registrant s telephone number, including area code: **(423) 989-8000**
Securities registered under Section 12(b) of the Exchange Act:

(Title of each class)	**(Name of each exchange on which registered)**
Common Stock and Associated Preferred Stock Purchase Rights	**New York Stock Exchange**

Securities registered under Section 12(g) of the Exchange Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of June 30, 2005 was $2,516,525,051 The number of shares of Common Stock, no par value, outstanding at February 27, 2006 was 242,080,103.

Documents Incorporated by Reference:

Certain information required in Part III of this Annual Report on Form 10-K is incorporated by reference from the registrant s Proxy Statement for its 2006 annual meeting of shareholders.

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PART I

Item 1. *Business*

King Pharmaceuticals, Inc. was incorporated in the State of Tennessee in 1993. Our wholly owned subsidiaries are Monarch Pharmaceuticals, Inc.; King Pharmaceuticals Research and Development, Inc.; Meridian Medical Technologies, Inc.; Parkedale Pharmaceuticals, Inc.; King Pharmaceuticals of Nevada, Inc.; and Monarch Pharmaceuticals Ireland Limited.

Our principal executive offices are located at 501 Fifth Street, Bristol, Tennessee 37620. Our telephone number is (423) 989-8000 and our facsimile number is (423) 274-8677. Our website is www.kingpharm.com where you may view our Corporate Code of Conduct and Ethics. To the extent permitted by U.S. Securities and Exchange Commission (SEC) and New York Stock Exchange (NYSE) regulations, we intend to disclose information as to any amendments to the Code and any waivers from provisions of the Code for our principal executive officer, principal financial officer, and certain other officers by posting the information on our website. We make available through our website, free of charge, our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and any amendments, as well as other documents, as soon as reasonably practicable after their filing. These filings are also available to the public over the Internet at the website of the SEC, at http://www.sec.gov. You may also read and copy any document that we file at the SEC s Public Reference Room located at 450 Fifth Street, NW, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room.

King is a vertically integrated pharmaceutical company that develops, manufactures, markets and sells branded prescription pharmaceutical products. By vertically integrated, we mean that we have the following capabilities:

sales and marketing,

research and development,

business development,

manufacturing,

packaging,

distribution,

quality control and assurance, and

regulatory management.

Through a national sales force and through marketing alliances, we market our branded pharmaceutical products to general/family practitioners, internal medicine physicians, cardiologists, endocrinologists, psychiatrists, neurologists, pain specialists, sleep specialists, and hospitals across the United States and in Puerto Rico.

Our corporate strategy is focused on three key therapeutic areas: cardiovascular/metabolic, neuroscience, and hospital/acute care products. We believe each of our key therapeutic areas has significant market potential and our organization is aligned accordingly.

Under our corporate strategy we work to achieve organic growth by maximizing the potential of our currently marketed products and through prudent product life-cycle management. By product life-cycle management, we mean the extension of the economic life of a product, including seeking and gaining all necessary related governmental approvals, by such means as:

securing U.S. Food and Drug Administration, which we refer to as the FDA, approved new label indications;

developing and producing different strengths;

producing different package sizes;

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developing new dosage forms; and

developing new product formulations.

Our strategy also focuses on growth through the acquisition of novel branded pharmaceutical products in later stages of development and the acquisition of pharmaceutical technologies, particularly those products and technologies that we believe have significant market potential and complement our three key therapeutic areas of focus. Using our internal resources and a disciplined business development process, we strive to be a leader and partner of choice in bringing innovative, clinically-differentiated therapies and technologies to market in our key therapeutic areas. We may also seek company acquisitions that add products or products in development, technologies or sales and marketing capabilities to our key therapeutic areas or that otherwise complement our operations. We also work to achieve organic growth by continuing to develop investigational drugs.

Branded pharmaceutical products represent one of our business segments. In accordance with our corporate strategy, our branded pharmaceutical products can be divided primarily into the following therapeutic areas:

cardiovascular/metabolic;

neuroscience;

hospital/acute care; and

other.

Our Meridian Medical Technologies segment consists of our auto-injector business, which includes EpiPen®. In March 2006, we acquired the rights to market and sell EpiPen® throughout Canada until 2015. Royalties, another of our business segments, are derived from products we previously successfully developed and have licensed to third parties. Additionally, we manufacture third-party pharmaceutical products under contracts with a variety of pharmaceutical and biotechnology companies. Accordingly, contract manufacturing represents a segment of our business.

The following table summarizes net revenues by operating segment (in thousands), almost all of which are derived from activities within the United States and Puerto Rico.

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Branded pharmaceuticals	$ 1,542,124	$ 1,076,517	$ 1,272,350
Meridian Medical Technologies	129,261	123,329	124,157
Royalties	78,128	78,474	68,365
Contract manufacturing	22,167	26,045	27,289
Other	1,201	(1)	628
Total	$ 1,772,881	$ 1,304,364	$ 1,492,789

For information regarding profit and loss and total assets associated with each segment, see Note 20 to the Notes to Consolidated Financial Statements in this report.

Recent Milestones

On March 1, 2006, we acquired substantially all of the assets of Allerex Laboratory LTD. The primary asset purchased from Allerex was the exclusive right to market and sell EpiPen® throughout Canada. We further negotiated with Dey, L.P., an extension of those exclusive rights to market and sell EpiPen® in Canada through 2015.

In February 2006, we entered into a collaboration with Arrow International Limited and certain of its affiliates (collectively, Arrow) to commercialize novel formulations of ramipril, the active ingredient in our Altace® product. Under a series of agreements, Arrow has granted us rights to certain current and

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future New Drug Applications (NDAs) regarding novel formulations of ramipril and intellectual property, including patent rights and technology licenses relating to these novel formulations. Under certain conditions, Arrow will be responsible for the manufacture and supply of new formulations of ramipril for us. Additionally, we have granted Cobalt Pharmaceuticals, Inc. a non-exclusive right to enter into the U.S. ramipril market with a generic form of the currently marketed Altace® product, which would be supplied by us. Cobalt is an affiliate of Arrow, but is not a party to the collaboration.

Pursuant to the agreements, we made an upfront payment to Arrow of $35.0 million. Arrow will also receive payments from us of $50.0 million based on the timing of certain events and could receive an additional $25.0 million based on the occurrence of certain conditions. Additionally, Arrow will earn fees for the manufacture and supply of new formulations of ramipril.

On December 6, 2005, we entered into a cross-license agreement with Mutual Pharmaceutical Company, Inc. Under the terms of the agreement, each party granted the other a license to certain intellectual property relating to metaxalone. Pursuant to the agreement, we paid Mutual $35.0 million and will pay royalties on net sales of metaxalone products. Our current formulation of metaxalone is Skelaxin®. The royalty rate may increase depending on the achievement of certain regulatory and commercial milestones.

On November 9, 2005, we entered into a collaborative agreement with Pain Therapeutics, Inc. to develop and commercialize Pain Therapeutics drug candidate Remoxy and other abuse-resistant opioid painkillers. Remoxy , which is an abuse-resistant version of long-acting oxycodone, is an investigational drug in late-stage clinical development for the treatment of severe to chronic pain. We have worldwide exclusive rights to commercialize Remoxy and the other abuse-resistant opioid drugs that are developed pursuant to the collaboration, other than in Australia and New Zealand. Under the terms of the agreement, we made an upfront cash payment of $150.0 million to Pain Therapeutics. We may also make additional cash milestone payments of up to $150.0 million based on the successful clinical and regulatory development of Remoxy and other abuse-resistant opioid products. This amount includes a $15.0 million cash payment upon acceptance of a regulatory filing for Remoxy and an additional $15.0 million upon its approval. In addition, we will pay all research and development expenses relating to the collaboration up to a maximum of $100.0 million. We will record net sales of all products subject to the collaboration and pay Pain Therapeutics a royalty of 15% of the cumulative net sales up to $1.0 billion and 20% of the cumulative net sales over $1.0 billion. We are also responsible for the payment of third-party royalty obligations of Pain Therapeutics related to products developed under this collaboration.

On August 12, 2004, we entered into a collaborative agreement with Palatin Technologies, Inc. to jointly develop and, on obtaining necessary regulatory approvals, commercialize Palatin s PT-141 compound, which is also known as bremelanotide, for the treatment of male and female sexual dysfunction. Pursuant to the terms of the agreement, Palatin has granted us a co-exclusive license with Palatin to PT-141 in North America and an exclusive right to collaborate in the licensing or sublicensing of PT-141 with Palatin outside North America. PT-141 is the first compound in a new drug class called melanocortin receptor agonists under development to treat sexual dysfunction. This new chemical entity is being evaluated in Phase II clinical trials studying the efficacy and safety profile of varying doses of this novel compound in men experiencing erectile dysfunction (ED) and women experiencing female sexual dysfunction (FSD). We paid Palatin approximately $20.0 million on entering into the collaborative agreement, which included a $3.4 million equity investment in Palatin. During the third quarter of 2005, we made an additional equity investment of $10.0 million in Palatin under the terms of the collaborative agreement. This investment reduced the equity portion of the milestone payments due Palatin upon completion of Phase II clinical trials by the same amount. In addition to the initial purchase price and the investment during 2005, we may also pay potential milestone payments to Palatin of up to $90.0 million for achieving certain ED and FSD development and regulatory approval targets. A portion of these milestone payments will consist of additional equity investments in Palatin. After regulatory approval and commercialization of PT-141, we may also pay potential milestone payments to Palatin of up to $130.0 million upon achieving specified annual North American net sales thresholds. We will share all

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collaboration, development and marketing costs associated with and net profits derived from PT-141 based upon an agreed percentage.

On June 12, 2003, we acquired the primary care business of Elan Corporation, plc, and that of some of its subsidiaries, in the United States and Puerto Rico, including the rights to Sonata® and Skelaxin®, and Elan s United States primary care field sales force. Product rights subject to the agreement include those related to Sonata®, a nonbenzodiazepine treatment for insomnia, and Skelaxin®, a muscle relaxant, in the United States, its territories and possessions, and Puerto Rico. Under the terms of the agreement, Elan s sale of Skelaxin® included related NDAs, copyrights, trademarks, patents and rights pertaining to potential new formulations of Skelaxin®. Elan s sale of Sonata® included its rights to the product, as well as certain related copyrights. We also acquired certain intellectual property, regulatory, and other assets relating to Sonata® directly from Wyeth. The total purchase price of $814.4 million included the cost of acquisition, assumed liabilities and a portion of contingent liabilities. The purchase price also included the transfer of inventory with a value of approximately $40.4 million. In addition to the initial purchase price, we paid $25.0 million during January 2004, as a milestone payment to Elan relating to the ongoing exclusivity of Skelaxin®. We also pay Wyeth royalties on the current formulation of Skelaxin® from the date of closing.

On January 8, 2003, we acquired Meridian Medical Technologies, Inc. for $253.9 million in cash paid to Meridian s shareholders in exchange for their shares of Meridian common stock. Meridian pioneered the development, and is the leading manufacturer, of auto-injectors for the self-administration of injectable drugs. An auto-injector is a pre-filled, pen-like device that allows a patient or caregiver to automatically inject a precise drug dosage quickly, easily, safely and reliably. Meridian s commercial pharmaceutical products primarily include EpiPen®, an auto-injector filled with epinephrine for the emergency treatment of anaphylaxis resulting from severe or allergic reactions to insect stings or bites, foods, drugs and other allergens, as well as idiopathic or exercise-induced anaphylaxis. Meridian manufactures EpiPen® under a supply agreement with Dey L.P., which markets the product. Other Meridian pharmaceutical products include:

- AtroPen® and ComboPen®, nerve agent antidotes;
- the Antidote Treatment Nerve Agent Auto-injector, a nerve gas antidote utilizing Meridian s patented dual chambered auto-injector and injection process; and
- auto-injectors filled with diazepam for treatment of seizures and morphine for pain management that are primarily sold to the U.S. Department of Defense (DoD) under an Industrial Base Maintenance Contract.

Meridian also markets nerve agent antidotes to allied foreign governments. These products are used by these foreign allies primarily for military defense purposes, and occasionally for homeland security.

Industry

The pharmaceuticals industry is a highly competitive global business composed of a variety of participants, including large and small branded pharmaceutical companies, specialty and niche-market pharmaceutical companies, biotechnology firms, large and small research and drug development organizations, and generic drug manufacturers. These participants compete on a number of factors, including technological innovation or novelty, clinical efficacy, safety, convenience or ease of administration and cost-effectiveness. In order to promote their products to physicians and consumers, industry participants devote considerable resources to advertising, marketing and sales force personnel, distribution mechanisms and relationships with medical and research centers, physicians and patient advocacy and support groups.

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The industry is affected by the following factors, among others:

the aging of the patient population, including diseases specific to the aging process and demographic factors, including obesity, diabetes, cardiovascular disease, and patient and physician demand for products that meet chronic or unmet medical needs;

technological innovation, both in drug discovery and corporate processes;

merger and acquisition activity whereby pharmaceutical companies are acquiring one another or smaller biotechnology companies and divestitures of products deemed non-strategic ;

cost containment and downward price pressure from managed care organizations and governmental entities, both in the United States and overseas;

increased drug development, manufacturing and compliance costs for pharmaceutical producers;

the rise of generic companies and challenges to patent protection and exclusivity;

more frequent product liability litigation;

increased governmental scrutiny of the healthcare sector, including issues of patient safety, cost, efficacy and reimbursement/insurance matters; and

the cost of advertising and marketing, including direct-to-consumer advertising on television and in print.

Branded Pharmaceuticals

We market a variety of branded prescription products that primarily can be divided into the following therapeutic areas:

cardiovascular/ metabolic (including Altace®, Corgard®, Levoxyl® and Cytomel®),

neuroscience (including Sonata® and Skelaxin®),

hospital/ acute care (including Thrombin-JMI®, Bicillin®, Synercid® and Intal®), and

other.

Our branded pharmaceutical products are generally in high-volume therapeutic categories and we believe they are well known for their indications (for example, Altace®, Skelaxin®, Sonata® and Levoxyl®). Branded pharmaceutical products represented 87.0% and 82.5% of our total net revenues for each of the years ended December 31, 2005 and 2004.

Cardiovascular/ Metabolic. Altace®, an angiotensin converting enzyme (ACE) inhibitor, is our primary product within this category. In August 1999, the results of the Heart Outcomes Prevention Evaluation trial (the HOPE trial) were released. The HOPE trial determined that Altace® significantly reduces the rates of stroke, myocardial infarction (heart attack) and death from cardiovascular causes in a broad range of high-risk cardiovascular patients. On October 4, 2000, the FDA approved our supplemental NDA (sNDA) related to Altace®. This approval permits the promotion of Altace® to reduce the risk of stroke, myocardial infarction (heart attack) and death from cardiovascular causes in patients 55 and over, with either a history of coronary artery disease, stroke or peripheral vascular disease, or with diabetes and one other cardiovascular risk factor (hypertension, elevated total cholesterol levels, low high-density lipoprotein (HDL) levels, cigarette smoking or documented microalbuminuria). Corgard® is a beta-blocker indicated for the management of hypertension as well as long-term management of patients with angina pectoris. Altace® and Corgard® are marketed primarily to primary care physicians and cardiologists. Levoxyl® and Cytomel®, which are

indicated for the treatment of thyroid disorders, are marketed primarily to primary care physicians and endocrinologists.

Neuroscience. Products in this category include Sonata® and Skelaxin®. Sonata® is a nonbenzodiazepine treatment for insomnia which is promoted primarily to primary care physicians,

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neurologists, psychiatrists and sleep specialists. Skelaxin® is a muscle relaxant indicated for the relief of discomforts associated with acute, painful musculoskeletal conditions. This product is marketed primarily to primary care physicians, neurologists, orthopedic surgeons and pain specialists.

Hospital/ Acute Care. Products in this category are marketed primarily to hospitals. Our largest products in this category are Thrombin-JMI®, Bicillin® and Synercid®. Thrombin-JMI® aids in controlling minor bleeding during surgery. Synercid® is an injectable antibiotic, primarily administered in hospitals, indicated for treatment of vancomycin-resistant enterococcus faecium and treatment of some complicated skin and skin structure infections. This category also includes several anti-infective products, including Bicillin®, that are marketed primarily to general/family practitioners and internal medicine physicians and are prescribed to treat uncomplicated infections of the respiratory tract, urinary tract, eyes, ears and skin. These products are generally in technologically mature product segments. Intal® and Tilade® are oral multi-dose inhalers of non-steroidal anti-inflammatory agents indicated for the preventive management of asthma.

Other. We also have other products that are marketed primarily to primary care physicians and certain specialists.

Some of our branded prescription products are described below:

Product	Product Description and Indication
Cardiovascular/ Metabolic	
Altace®(1)	A hard-shell capsule for oral administration indicated for the treatment of hypertension and reduction of the risk of stroke, myocardial infarction (heart attack) and death from cardiovascular causes in patients 55 and over with either a history of coronary artery disease, stroke or peripheral vascular disease or with diabetes and one other cardiovascular risk factor (such as elevated cholesterol levels or cigarette smoking). Altace® is also indicated in stable patients who have demonstrated clinical signs of congestive heart failure after sustaining acute myocardial infarction.
Corgard®(2)	A beta-blocker tablet, indicated for the management of hypertension as well as long-term management of patients with angina pectoris.
Levoxyl®	Color-coded, potency marked tablets indicated for thyroid hormone replacement or supplemental therapy for hypothyroidism.
Cytomel®	A tablet indicated in the medical treatment of hypothyroidism. The only commercially available thyroid hormone tablet containing T(3) as a single entity.
Neuroscience	
Sonata®	A nonbenzodiazepine capsule treatment for insomnia.
Skelaxin®	A muscle relaxant tablet indicated for the relief of discomforts associated with acute, painful musculoskeletal conditions.

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Product	Product Description and Indication
Hospital/ Acute Care	
Thrombin-JMI®	A chromatographically purified topical (bovine) thrombin solution indicated as an aid to hemostasis whenever oozing blood and minor bleeding from capillaries and small venules is accessible.
Synercid®	An injectable antibiotic indicated for treatment of certain complicated skin and skin structure infections.
Bicillin®	A penicillin-based antibiotic suspension for deep muscular injection indicated for the treatment of infections due to penicillin-G-susceptible microorganisms that are susceptible to serum levels common to this particular dosage form.
Intal®	An oral multi-dose inhaler of a non-steroidal anti-inflammatory agent for the preventive management of asthma.
Tilade®	An oral multi-dose inhaler of a non-steroidal anti-inflammatory agent for the preventive management of asthma.
Other	
Menest®	A film-coated esterified estrogen tablet for the treatment of vasomotor symptoms of menopause, atrophic vaginitis, kraurosis valvae, female hypogonadism, female castration, primary ovarian failure, breast cancer and prostatic carcinoma.
Delestrogen®	An injectable estrogen replacement therapy.
Aplisol®	Aids in the detection of infections with mycobacterium tuberculosis.
Neosporin®(3)	A prescription strength ophthalmic ointment and solution indicated for the topical treatment of ocular infections. It is also formulated as a prescription strength genito-urinary concentrated sterile irrigant indicated for short-term use as a continuous irrigant or rinse to help prevent infections associated with the use of indwelling catheters.

(1) We acquired licenses for the exclusive rights in the United States under various patents to the active ingredient in Altace®.

(2) We acquired a fully paid license to Corgard® in the United States.

(3) We have exclusive licenses, free of royalty obligations, to manufacture and market prescription formulations of Neosporin®.

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Net sales of certain of our branded prescription products for the year ended December 31, 2005 are set forth in the tables below.

	Net sales (in millions)
Cardiovascular/Metabolic	
Altace®	$ 554.4
Levoxyl®	139.5
Cytomel®	36.2
Corgard®	6.6
Neuroscience	
Skelaxin®	$ 344.6
Sonata®	83.2
Hospital/Acute Care	
Thrombin-JMI®	$ 220.6
Bicillin®	54.0
Synercid®	12.4
Intal®	12.2
Other	
Aplisol®	$ 16.4
Neosporin®	9.6
Menest®	7.3
Delestrogen®	6.2

Meridian Medical Technologies

Our Meridian Medical Technologies segment consists primarily of our auto-injector business. We pioneered the development, and are a manufacturer, of auto-injectors for the self-administration of injectable drugs. An auto-injector is a pre-filled, pen-like device that allows a patient or caregiver to automatically inject a precise drug dosage quickly, easily, safely and reliably. Auto-injectors are a convenient, disposable, one-time use drug delivery system designed to improve the medical and economic value of injectable drug therapies.

The commercial pharmaceutical business of our Meridian segment primarily consists of EpiPen®, an auto-injector filled with epinephrine for the emergency treatment of anaphylaxis resulting from severe or allergic reactions to insect stings or bites, foods, drugs and other allergens, as well as idiopathic or exercise-induced anaphylaxis. We have a supply agreement with Dey, L.P., in which we granted Dey the exclusive right to market, distribute, and sell EpiPen® worldwide. The supply agreement expires December 31, 2015.

Our Meridian segment also includes pharmaceutical products that are presently sold primarily to the DoD, under an Industrial Base Maintenance Contract which is terminable by the DoD at its convenience. These products include the nerve agent antidotes AtroPen® and ComboPen®, and the Antidote Treatment Nerve Agent Auto-injector, which we refer to as the ATNAA. AtroPen® is an atropine-filled auto-injector and ComboPen® consists of an atropine-filled auto-injector and a pralidoxime-filled auto-injector. The ATNAA utilizes a dual chambered auto-injector and injection process to administer atropine and pralidoxime, providing an improved, more efficient means of delivering these nerve agent antidotes. Other products sold to the DoD also include a diazepam-filled auto-injector for the treatment of seizures and a morphine-filled auto-injector for pain management.

On March 1, 2006, we acquired substantially all of the assets of Allerex Laboratory LTD. The primary asset purchased from Allerex was the exclusive right to market and sell EpiPen® throughout Canada. We further negotiated with Dey, L.P., an extension of those exclusive rights to market and sell EpiPen® in Canada through 2015.

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Royalties

We have successfully developed two currently marketed adenosine-based products, Adenoscan® and Adenocard®, for which we receive royalty revenues. Specifically, we are party to an agreement under which Astellas Pharma US, Inc. (formerly Fujisawa Healthcare, Inc.) manufactures and markets Adenoscan® and Adenocard® in the United States and Canada in exchange for royalties. We have licensed exclusive rights to Sanofi-Aventis SA to manufacture and market Adenocard® in countries other than the United States, Canada and Japan in exchange for royalties. We have licensed exclusive rights to Sanofi-Aventis to manufacture and market Adenoscan® in Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom in exchange for royalties. Sanofi-Aventis has received marketing approval for Adenoscan® in a number of these countries. We have licensed exclusive rights to Suntory to manufacture and market Adenoscan® and Adenocard® in Japan in exchange for royalties.

Royalties received by us from sales of Adenoscan® and Adenocard® outside of the United States and Canada are shared equally with Astellas. Astellas, on its own behalf and ours, obtained a license to additional intellectual property rights for intravenous adenosine in cardiac imaging and the right to use intravenous adenosine as a cardioprotectant in combination with thrombolytic therapy, balloon angioplasty and coronary bypass surgery. For additional information on our royalty agreements, please see the section below entitled Intellectual Property.

Contract Manufacturing

We utilize a portion of our excess manufacturing capacity to provide third-party contract manufacturing. We currently provide contract manufacturing for other pharmaceutical and biotechnology companies. Contract manufacturing as a percentage of total revenues equaled approximately 1.3% for the year ended December 31, 2005. We believe contract manufacturing provides a means of absorbing overhead costs and, as such, is an efficient utilization of excess capacity.

Sales and Marketing

Our commercial operations organization, which includes sales and marketing, is based in Princeton, New Jersey. We have a sales force consisting of approximately 1,000 individuals in the United States and Puerto Rico. We distribute our branded pharmaceutical products primarily through wholesale pharmaceutical distributors. These products are ordinarily dispensed to the public through pharmacies by prescription. Our marketing and sales promotions for branded pharmaceutical products principally target general/family practitioners, internal medicine physicians, cardiologists, endocrinologists, neurologists, psychiatrists, pain specialists, sleep specialists and hospitals through detailing and sampling to encourage physicians to prescribe more of our products. The sales force is supported and supplemented by co-promotion arrangements, telemarketing and direct mail, as well as through advertising in trade publications and representation at regional and national medical conventions. Our telemarketing and direct mailing efforts are performed primarily by using a computer sampling system which we developed to distribute samples to physicians. We identify and target physicians through data available from IMS America, Ltd. and Scott-Levin, suppliers of prescriber prescription data. We seek new international markets for product lines for which we have international rights. The marketing and distribution of these products in foreign countries generally require the prior registration of the products in those countries. We generally seek to enter into distribution agreements with companies with established foreign marketing and distribution capabilities since we do not have a distribution mechanism in place for distribution outside the United States and Puerto Rico.

Similar to other pharmaceutical companies, our principal customers are wholesale pharmaceutical distributors. The wholesale distributor network for pharmaceutical products has in recent years been subject to increasing consolidation, which has increased our, and other industry participants , customer concentration. In addition, the number of independent drug stores and small chains has decreased as retail consolidation has occurred. For the year ended December 31, 2005, approximately 69% of our gross sales

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were attributable to three key wholesalers: Cardinal/Bindley (28%), McKesson Corporation (27%) and Amerisource Bergen Corporation (14%).

Manufacturing

Our manufacturing facilities are located in Bristol, Tennessee; Rochester, Michigan; Middleton, Wisconsin; St. Petersburg, Florida; and St. Louis, Missouri. These facilities have manufacturing, packaging, laboratory, office and warehouse space. We are licensed by the Drug Enforcement Agency, which we refer to as the DEA, a division of the Department of Justice, to procure and produce controlled substances. We manufacture certain of our own branded pharmaceutical products, as well as products owned by other pharmaceutical companies under manufacture and supply contracts.

We can produce a broad range of dosage forms, including sterile solutions, lyophylized (freeze-dried) products, injectables, tablets and capsules, creams and ointments, suppositories and powders. We believe our manufacturing capabilities allow us to capture higher margins and pursue drug development and product line extensions more efficiently. We manufacture a portion of the finished dosage form of Altace® at our Bristol facility. However, currently many of our product lines, including Skelaxin®, Sonata®, Delestrogen®, Intal®, Tilade®, Synercid® and Cortisporin® are manufactured for us by third parties. As of December 31, 2005, we estimate capacity utilization was approximately 30% at the Bristol facility, approximately 20% at the Rochester facility, approximately 100% at the Middleton facility, approximately 65% at the St. Petersburg facility and approximately 75% at the St. Louis facility.

In addition to manufacturing, we have fully integrated manufacturing support systems including quality assurance, quality control, regulatory management and logistics. We believe that these support systems enable us to maintain high standards of quality for our products and simultaneously deliver reliable services and goods to our customers on a timely basis. Companies that do not have such support systems in-house must outsource these services.

We require a supply of quality raw materials and components to manufacture and package drug products for us and for third parties with whom we have contracted. Generally, we have not had difficulty obtaining raw materials and components from suppliers. Currently, we rely on more than 500 suppliers to deliver the needed raw materials and components for our products.

Research and Development

We are engaged in the development of chemical compounds, including new chemical entities, which provide us with strategic pipeline opportunities for the commercialization of new branded prescription pharmaceutical products. In addition to developing new chemical compounds, we pursue means of enhancing the value of existing products through new uses, formulations, and drug delivery technology that may provide additional benefits to patients and improvements in the quality and efficiency of our manufacturing processes.

We invest in research and development because we believe it is important to our long-term growth. We presently employ approximately 70 people in research and development, including pre-clinical and toxicology experts, pharmaceutical formulations scientists, clinical development experts, medical affairs personnel, regulatory affairs experts, data scientists/statisticians and project managers.

In the conduct of our research and development, we utilize a virtual model led by our project management personnel, providing us with substantial flexibility and allowing high efficiency while minimizing internal fixed costs. Utilizing this model, we supplement our internal efforts by collaborating with independent research organizations, including educational institutions and research-based pharmaceutical and biotechnology companies, and contracting with other parties to perform research in their facilities. We use the services of physicians, hospitals, medical schools, universities, and other research organizations worldwide to conduct clinical trials to establish the safety and effectiveness of new products. We seek investments in external research and technologies that hold the promise to complement and strengthen our

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own research efforts. These investments can take many forms, including in-licensing arrangements, development agreements, joint ventures, and the acquisition of products in development.

Drug development is time-consuming and expensive. Only a small percentage of chemical compounds discovered by researchers prove to be both medically effective and safe enough to become an approved medicine. The process from discovery to regulatory approval typically takes 10 to 15 years or longer. Drug candidates can fail at any stage of the process, and even late-stage product candidates sometimes fail to receive regulatory approval.

Clinical trials are conducted in a series of sequential phases, with each phase designed to address a specific research question. In Phase I clinical trials, researchers test a new drug or treatment in a small group of people to evaluate the drug s safety, determine a safe dosage range, and identify side effects. In Phase II clinical trials, researchers give the drug or treatment to a larger population to assess effectiveness and to further evaluate safety. In Phase III clinical trials, researchers give the drug or treatment to an even larger population to confirm its effectiveness, monitor side effects, compare it to commonly used treatments, and collect information that will allow the drug or treatment to be used safely. The results of Phase III clinical trials are pivotal for purposes of obtaining FDA approval of a new product.

Our development projects, including those for which we have collaboration agreements with third parties, include the following:

Remoxy™, an investigational drug for the treatment of severe to chronic pain, which is currently in Phase III clinical trials;

Binodenoson, our next generation cardiac pharmacologic stress-imaging agent, which is currently in Phase III clinical trials;

Vanquix™, a diazepam-filled auto-injector for the treatment of acute, repetitive epileptic seizures, which is currently in Phase III clinical trials;

PT-141, an investigational drug for the treatment of ED and FSD, which is currently in late Phase II clinical trials;

MRE0094, an investigational drug for the topical treatment of chronic diabetic neuropathic foot ulcers, which is currently in Phase II clinical trials; and

T-62, an investigational drug for the treatment of neuropathic pain, for which we have completed Phase I clinical trials.

Development projects, including those in which we have collaboration agreements with third parties, that involve currently marketed compounds include the following:

a novel formulation involving ramipril for which an NDA is pending;

an Altace®/diuretic combination product;

a large multinational study (DREAM) to evaluate the ability of Altace® to prevent diabetes;

a program to evaluate whether Altace® slows the progression of chronic kidney disease, for which an sNDA was submitted to the FDA last year;

a program to evaluate the safety and efficacy of Altace® in children, for which an sNDA was submitted to the FDA last year, and for which we expect to receive an additional six months of patent exclusivity;

a new formulation of Intal®, for the long-term management of asthma, utilizing the environmentally friendly propellant hydrofluoroalkane (HFA); and

a potential new formulation of metaxalone®.

Our research and development expenses were $74.0 million in 2005, $67.9 million in 2004 and $44.1 million in 2003, excluding research and development in-process at the time of acquisition of a

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product. In-process research and development expenses were $188.7 million for the year ended December 31, 2005, $16.3 million for the year ended December 31, 2004 and $194.0 million for the year ended December 31, 2003.

Government Regulation

Our business and our products are subject to extensive and rigorous regulation at both the federal and state levels. Nearly all of our products are subject to pre-market approval requirements. New drugs are approved under, and are subject to, the Food, Drug and Cosmetics Act (FDC Act), and related regulations. Biological drugs are subject to both the FDC Act and the Public Health Service Act, which we refer to as the PHS Act, and related regulations. Biological drugs are licensed under the PHS Act.

At the federal level, we are principally regulated by the FDA as well as by the DEA, the Consumer Product Safety Commission, the Federal Trade Commission, the U.S. Department of Agriculture, the Occupational Safety and Health Administration, and the U.S. Environmental Protection Agency (EPA). The FDC Act, the regulations promulgated thereunder, and other federal and state statutes and regulations, govern, among other things, the development, testing, manufacture, safety, effectiveness, labeling, storage, record keeping, approval, advertising and promotion of our products and those manufactured by and for third parties. Product development and approval within this regulatory framework requires a number of years and involves the expenditure of substantial resources.

When we acquire the right to market an existing approved pharmaceutical product, both we and the former application holder are required to submit certain information to the FDA. This information, if adequate, results in the transfer to us of marketing rights to the pharmaceutical products. We are also required to report to the FDA, and sometimes acquire prior approval from the FDA, certain changes in an approved NDA, as set forth in the FDA s regulations. When advantageous, we transfer the manufacture of acquired branded pharmaceutical products to other manufacturing facilities which may include our manufacturing facilities, when appropriate, after regulatory requirements are satisfied. In order to transfer manufacturing of acquired products, the new manufacturing facility must demonstrate, by filing information with the FDA, that it can manufacture the product in accordance with current Good Manufacturing Practices, referred to as cGMPs, and the specifications and conditions of the approved marketing application. For changes requiring pre-market approval, there can be no assurance that the FDA will grant such approval in a timely manner, if at all.

The FDA also mandates that drugs be manufactured, packaged and labeled in conformity with cGMPs. In complying with cGMPs, manufacturers must continue to expend time, money and effort in production, record keeping and quality control to ensure that the products meet applicable specifications and other requirements to ensure product safety and efficacy.

The FDA and other government agencies periodically inspect drug manufacturing facilities to ensure compliance with applicable cGMP and other regulatory requirements. Failure to comply with these statutory and regulatory requirements subjects the manufacturer to possible legal or regulatory action, such as suspension of manufacturing, seizure of product or recall of a product. Adverse experiences with the use of products must be reported to the FDA and could result in the imposition of market restrictions through labeling changes or in product removal. Product approvals may be withdrawn if compliance with regulatory requirements is not maintained or if problems concerning safety or efficacy of the product occur following approval.

The federal government has extensive enforcement powers over the activities of pharmaceutical manufacturers including the authority to withdraw product approvals, commence actions to seize and prohibit the sale of unapproved or non-complying products, to halt manufacturing operations that are not in compliance with cGMPs, and to impose or seek injunctions, voluntary or involuntary recalls, and civil monetary and criminal penalties. Such a restriction or prohibition on sales or withdrawal of approval of products marketed by us could materially adversely affect our business, financial condition or results of operations.

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We also manufacture and sell pharmaceutical products which are controlled substances as defined in the Controlled Substances Act and related federal and state laws, which establish certain security, licensing, record keeping, reporting and personnel requirements administered by the DEA and state authorities. The DEA has a dual mission of law enforcement and regulation. The former deals with the illicit aspects of the control of abusable substances and the equipment and raw materials used in making them. The DEA shares enforcement authority with the Federal Bureau of Investigation, another division of the Department of Justice. The DEA s regulatory responsibilities are concerned with the control of licensed manufacturers, distributors and dispensers of controlled substances, the substances themselves and the equipment and raw materials used in their manufacture and packaging in order to prevent such articles from being diverted into illicit channels of commerce. We maintain appropriate licenses and certificates with the DEA and applicable state authorities in order to engage in the development, manufacturing and distribution of pharmaceutical products containing controlled substances.

The distribution of pharmaceutical products is subject to the Prescription Drug Marketing Act (PDMA), a part of the FDC Act, which regulates distribution activities at both the federal and state level. Under the PDMA and its implementing regulations, states are permitted to require registration of manufacturers and distributors who provide pharmaceuticals even if these manufacturers or distributors have no place of business within the state. States are also permitted to adopt regulations limiting the distribution of product samples to licensed practitioners. The PDMA also imposes extensive licensing, personnel record keeping, packaging, quantity, labeling, product handling and facility storage and security requirements intended to prevent the sale of pharmaceutical product samples or other diversions.

A number of states have passed laws specifically designed to track and regulate specified activities of pharmaceutical companies. Other states presently have pending legislation that will have similar effects. Some of these state laws require the tracking and reporting of advertising or marketing activities within the state. Others limit spending on items provided to healthcare providers or state officials.

We cannot determine what effect new laws, changes in regulations, statutes or legal interpretation, when and if adopted or enacted, may have on our business in the future. New laws, regulations, standards, or interpretations could, among other things, require changes to manufacturing methods, expanded or different labeling, the recall, replacement or discontinuance of certain products, additional record keeping or expanded documentation or could limit the way we advertise and/ or market our products. These changes, or new legislation, could have a material adverse effect on our business, financial condition or results of operations.

Environmental Matters

Our operations are subject to numerous and increasingly stringent federal, state and local environmental laws and regulations concerning, among other things, the generation, handling, storage, transportation, treatment and disposal of toxic and hazardous substances and the discharge of pollutants into the air and water. Environmental permits and controls are required for some of our operations and these permits are subject to modification, renewal and revocation by the issuing authorities. We believe that our facilities are in substantial compliance with our permits and environmental laws and regulations and do not believe that future compliance with current environmental laws will have a material adverse effect on our business, financial condition or results of operations. Our environmental capital expenditures and costs for environmental compliance may increase in the future as a result of changes in environmental laws and regulations or as a result of increased manufacturing activities at any of our facilities.

Competition

General

We compete with other pharmaceutical companies, including large, global pharmaceutical companies, for the acquisition of products and technologies in later stages of development. We also compete with other pharmaceutical companies for currently marketed products and product line acquisitions. Competitors include Biovail Corporation, Forest Laboratories, Inc., Shire Pharmaceuticals Group plc,

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Medicis Pharmaceutical Corporation, Watson Pharmaceuticals, Inc., Wyeth, Pfizer Inc., Bristol Myers Squibb, Sanofi Aventis, GlaxoSmithKline and other companies which also acquire branded pharmaceutical products and product lines from, and enter into licensing arrangements with, other pharmaceutical companies. Additionally, since our products are generally established and commonly sold, they are subject to competition from products with similar qualities. Our branded pharmaceutical products may be subject to competition from alternate therapies during the period of patent protection and thereafter from generic equivalents. The manufacturers of generic products typically do not bear the related research and development costs and consequently are able to offer such products at considerably lower prices than the branded equivalents. There are, however, a number of factors which enable products to remain profitable once patent protection has ceased. These include the establishment of a strong brand image with the prescriber or the consumer, supported by the development of a broader range of alternative formulations than the manufacturers of generic products typically supply.

Generic Substitutes

Many of our branded pharmaceutical products have either a strong market niche or competitive position. Some of our branded pharmaceutical products face competition from generic substitutes. For a manufacturer to launch a generic substitute, it must prove to the FDA when filing an application to make a generic substitute that the branded pharmaceutical product and the generic substitute are therapeutically bioequivalent. By focusing our efforts in part on products with patent protection, challenging bioequivalence or complex manufacturing requirements, we believe that we are better positioned to maintain market share and produce sustainable, high margins and cash flows.

The FDA requires that generic applicants claiming invalidity or non-infringement of status listed by a NDA holder give the NDA holder notice each time an abbreviated new drug application (ANDA,) is either submitted or amended to claim invalidity or non-infringement of listed patents. If the NDA holder files a patent infringement suit against the generic applicant within 45 days of receiving such notice, the FDA is barred (or stayed) from approving the ANDA for 30 months unless specific events occurred sooner. To avoid multiple 30-month stays for the same branded drug, the relevant provisions of the Hatch-Waxman Act (21 U.S.C. §§ 355(j)(2) and (5)) indicate that a 30-month stay will only attach to patents that are listed in the FDA s Approved Drug Products with *Therapeutic Equivalence Evaluations*, which we refer to as the FDA s Orange Book, at the time an ANDA is originally filed. Although the ANDA filer is still required to certify against a newly-listed patent, the NDA holder can still bring suit based upon infringement of that patent, but such a suit will not trigger an additional 30-month stay of FDA approval of the ANDA.

Only patents listed in the FDA s Orange Book are eligible for protection by a 30-month stay of FDA approval of the ANDA. We are required to list all patents that claim a composition of matter relating to a drug or a method of using a drug. The FDA s regulations prohibit listing of certain types of patents, including patents claiming certain metabolites (the active moiety that results from the body s metabolism of the drug substance), intermediates (namely, substances not present in the finished product), certain methods of use, or patents claiming certain product packaging. As such, some patents that may issue are not eligible for listing in the FDA s Orange Book and thus not eligible for protection by a 30-month stay.

Intellectual Property

Patents, Licenses and Proprietary Rights

We consider the protection of discoveries in connection with our development activities important to our business. The patent positions of pharmaceutical companies, including ours, are uncertain and involve legal and factual questions which can be difficult to resolve. We seek patent protection in the United States and selected foreign countries where and when appropriate.

In connection with the Altace® product line, we acquired a license for the exclusive rights in the United States and Puerto Rico to various Aventis patents, including the rights to the active ingredients in Altace® having patents listed in the FDA s Orange Book that expire in October 2008 and April 2012. Our

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rights include the use of the active ingredients in Altace® generally in combination as human therapeutic or human diagnostic products in the United States.

Skelaxin® has two method-of-use patents listed in the FDA s Orange Book, which do not expire until December 2021.

Sonata® has a composition of matter patent listed in the FDA s Orange Book that expires in June 2008.

We own patent rights in the United States related to the HFA formulation of Intal® until September 2017, a composition of matter patent in the United States for Tilade® until October 2006 and a formulation patent in the United States for Synercid® until November 2017.

We have exclusive licenses expiring in June 2036 for the prescription formulations of Neosporin®. These licenses are subject to early termination in the event we fail to meet specified quality control standards, including cGMP regulations with respect to the products, or commit a material breach of other terms and conditions of the licenses which would have a significant adverse effect on the uses of the licensed products retained by the licensor, including, among other things, marketing products under these trade names outside the prescription field.

We own the intellectual property rights associated with Meridian s dual-chambered auto-injector and injection process, which include a patent in the United States that expires in April 2010.

We receive royalties on sales of Adenoscan®, a product that we successfully developed. Adenoscan® has patent coverage that extends to March 2015.

In addition to the intellectual property for the currently marketed products described above, we also have acquired intellectual property related to various products currently under development. For example, we have acquired rights to intellectual property relating to T-62 and certain related backup compounds currently under development for the treatment for neuropathic pain. In connection with our collaborative agreement with Pain Therapeutics, Inc., we have acquired an exclusive license (subject to preexisting license rights granted by Pain Therapeutics) to certain intellectual property rights related to opioid formulations, including Remoxy , which is currently in development for the treatment of moderate-to-severe chronic pain. In connection with our collaborative agreement with Palatin Technologies, Inc., we have acquired a co-exclusive license to intellectual property rights related to PT-141, currently being developed for the treatment of male and female sexual dysfunction. Furthermore, in connection with the development of MRE0094, we have acquired exclusive licenses to composition and method patents related to adenosine receptor agonists for the topical treatment of chronic diabetic foot ulcers. Also, we have acquired exclusive rights to patents related to binodenoson, the pharmacologic stress agent specific to the adenosine receptor necessary for increased cardiac blood flow. Also, we have acquired certain intellectual property rights from Mutual Pharmaceutical Company, Inc. related to metaxalone, the active pharmaceutical ingredient in Skelaxin®, and we have acquired certain intellectual property rights from Arrow related to ramipril, the active pharmaceutical ingredient in Altace,® as previously discussed.

We also rely upon trade secrets, unpatented proprietary know-how and continuing technological innovation to develop and sustain our competitive position. There can be no assurance that others will not independently develop substantially equivalent proprietary technology and techniques or otherwise gain access to our trade secrets or disclose the technology or that we can adequately protect our trade secrets.

For a discussion of challenges to our patents by generic drug manufacturers, please see the section entitled Risk Factors under the heading If we cannot successfully enforce our rights under the patents relating to three of our largest products, Altace®, Skelaxin® and Sonata®, and the patent relating to Adenoscan®, or if we are unable to secure or enforce our rights under other patents, trademarks, trade secrets or other intellectual property, our results of operations could be materially adversely affected.

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Trademarks

We sell our branded products under a variety of trademarks. We believe that we have valid proprietary interests in all currently used trademarks, including those for our principal branded pharmaceutical products registered in the United States.

Backlog

As of February 24, 2006, we had no material backlog.

Employees

As of February 24, 2006, we employed 2,795 full-time and four part-time persons. Approximately 185 employees of the Rochester facility are covered by a collective bargaining agreement with the Paper, Allied Industrial, Chemical & Energy Workers, International Union (PACE), Local No. 60178, which expires on February 28, 2008. Approximately 301 employees of the St. Louis facility are covered by a collective bargaining agreement with the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America Union, Local No. 688, which expires February 28, 2008. We believe our employee relations are good.

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Item 1A. ***Risk Factors***

You should carefully consider the risks described below and the other information contained in this report, including our audited consolidated financial statements and related notes. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. If any of the adverse events described in this Risk Factors section or other sections of this report actually occurs, our business, results of operations and financial condition could be materially adversely affected, the trading price, if any, of our securities could decline and you might lose all or part of your investment.

Risks Related to our Business

The securities and derivative litigation or the continuing SEC investigation could have a material adverse effect on our business.

Subsequent to the announcement of the SEC investigation described in Item 3, Legal Proceedings , beginning in March 2003, 22 purported class action complaints were filed by holders of our securities against us, our directors, former directors, our executive officers, former executive officers, a subsidiary, and a former director of the subsidiary in the United States District Court for the Eastern District of Tennessee, alleging violations of the Securities Act of 1933 and/or the Securities Exchange Act of 1934 in connection with our underpayment of rebates owed to Medicaid and other governmental pricing programs, and certain transactions between us and the Benevolent Fund. These 22 complaints have been consolidated in the United States District Court for the Eastern District of Tennessee. In addition, holders of our securities filed two class action complaints alleging violations of the Securities Act of 1933 in Tennessee state court. We removed these two cases to the United States District Court for the Eastern District of Tennessee, where these two cases were consolidated with the other class actions. The district court has appointed lead plaintiffs in the consolidated action, and those lead plaintiffs filed a consolidated amended complaint on October 21, 2003, alleging that we, through some of our executive officers, former executive officers, directors, and former directors, made false or misleading statements concerning our business, financial condition, and results of operations during periods beginning February 16, 1999 and continuing until March 10, 2003. Plaintiffs in the consolidated action have also named the underwriters of our November 2001 public offering as defendants. We and other defendants filed motions to dismiss the consolidated amended complaint.

On August 12, 2004, the United States District Court for the Eastern District of Tennessee ruled on defendants motions to dismiss. The Court dismissed all claims as to Jones Pharma Incorporated, a predecessor to one of our wholly owned subsidiaries, King Pharmaceuticals Research and Development, Inc. (King Research and Development), and as to defendants Dennis Jones and Henry Richards. The Court also dismissed certain claims as to five other individual defendants. The Court denied the motions to dismiss in all other respects. Following the Court s ruling, on September 20, 2004, we and the other remaining defendants filed answers to plaintiffs consolidated amended complaint. Discovery in this action has commenced. The Court has set a trial date of April 10, 2007.

We have estimated a probable loss contingency for the class action lawsuit described above. We believe this loss contingency will be paid on behalf of us by our insurance carriers. Accordingly, as of December 31, 2005, we have recorded a liability and a receivable for this amount, classified in accrued expenses and prepaid and other current assets, respectively, in our consolidated financial statements.

Beginning in March 2003, four purported shareholder derivative complaints were also filed in Tennessee state court alleging a breach of fiduciary duty, among other things, by some of our current and former officers and directors, with respect to the same events at issue in the federal securities litigation described above. These cases have been consolidated, and on October 3, 2003, plaintiffs filed a consolidated amended complaint. On November 17, 2003, defendants filed a motion to dismiss or stay the consolidated amended complaint. The court denied the motion to dismiss, but granted a stay of proceedings. On October 11, 2004, the court lifted the stay to permit plaintiffs to file a further amended complaint adding class action claims related to our then-anticipated merger with Mylan Laboratories, Inc.

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On October 26, 2004, defendants filed a partial answer to the further amended complaint, and moved to dismiss the newly-added claims. Following the termination of the Mylan merger agreement, plaintiffs voluntarily dismissed these claims. Discovery with respect to the remaining claims in the case has commenced. No trial date has been set.

Beginning in March 2003, three purported shareholder derivative complaints were likewise filed in Tennessee federal court, asserting claims similar to those alleged in the state derivative litigation. These cases have been consolidated, and on December 2, 2003 plaintiffs filed a consolidated amended complaint. On March 9, 2004, the court entered an order indefinitely staying these cases in favor of the state derivative action.

In August 2004, a separate class action lawsuit was filed in Tennessee state court, asserting claims solely with respect to our then-anticipated merger with Mylan Laboratories. Defendants filed a motion to dismiss the case on November 30, 2004, which remains pending. We believe that the claims in this case are moot following termination of the Mylan merger agreement.

Additionally, a class action complaint was filed in the United States District Court for the Eastern District of Tennessee under the Employee Retirement Income Security Act, which we refer to as ERISA. As amended, the complaint alleged that we and certain of our executive officers, former executive officers, directors, former directors and an employee violated fiduciary duties that they allegedly owed our 401(k) Retirement Savings Plan s participants and beneficiaries under ERISA. The allegations underlying this action were similar in many respects to those in the class action litigation described above. The defendants filed a motion to dismiss the ERISA action on March 5, 2004. The District Court Judge referred the motion to a Magistrate Judge for a report and recommendation. On December 8, 2004, the Magistrate Judge held a hearing on this motion, and, on December 10, 2004, he recommended that the District Court Judge dismiss the action. The District Court Judge accepted the recommendation and dismissed the case on February 4, 2005. The plaintiffs have not appealed this decision and the deadline for filing any appeal has now passed.

The SEC investigation of our previously disclosed errors relating to reserves for product returns is continuing, and it is possible that this investigation could result in the SEC s imposing fines or other sanctions on us.

We are unable currently to predict the outcome or reasonably estimate the range of potential loss, if any, except as noted above, in the pending litigation. If we were not to prevail in the pending litigation, or if any governmental sanctions are imposed in excess of those described above, neither of which we can predict or reasonably estimate at this time, our business, financial condition, results of operations and cash flows could be materially adversely affected. Responding to the SEC investigation and defending us in the pending litigation has resulted, and is expected to continue to result, in a significant diversion of management s attention and resources and the payment of additional professional fees.

If we cannot successfully enforce our rights under the patents relating to three of our largest products, Altace®, Skelaxin® and Sonata®, and the patent relating to Adenoscan®, or if we are unable to secure or enforce our rights under other patents, trademarks, trade secrets or other intellectual property, our results of operations could be materially adversely affected.

Cobalt Pharmaceuticals, Inc. (Cobalt), a generic drug manufacturer located in Mississauga, Ontario, Canada, filed an ANDA with the FDA seeking permission to market a generic version of Altace®. The following U.S. patents are listed for Altace® in the FDA s Approved Drug Products with Therapeutic Equivalence Evaluations, which is known as the Orange Book ; United States Patent No. 5,061,722 (the 722 patent), a composition-of-matter patent, and United States Patent No. 5,403,856 (the 856 patent), a method-of-use patent, with expiration dates of October 2008 and April 2012, respectively. Under the Hatch-Waxman Act, any generic manufacturer may file an ANDA with a certification, known as a Paragraph IV certification, challenging the validity or infringement of a patent listed in the FDA s Orange Book four years after the pioneer company obtains approval of its

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NDA. Cobalt filed a Paragraph IV certification alleging invalidity of the 722 patent, and Aventis Pharma Deutschland GmbH (Aventis) and the Company filed suit on March 14, 2003, in the District Court for the District of Massachusetts to enforce our rights under that patent. Pursuant to the Hatch-Waxman Act, our filing of that suit provided us an automatic stay of FDA approval of Cobalt s ANDA for 30 months from no earlier than February 5, 2003. That 30 month stay expired in August 2005 and on October 24, 2005, the FDA granted final approval of Cobalt s ANDA. In March 2004, Cobalt stipulated to infringement of the 722 patent. Subsequent to filing our original complaint, we amended our complaint to add an allegation of infringement of the 856 patent. The 856 patent covers one of Altace® s three indications for use. In response to the amended complaint, Cobalt informed the FDA that it no longer seeks approval to market its proposed product for the indication covered by the 856 patent. On this basis, the court granted Cobalt summary judgment of non-infringement of the 856 patent. The court s decision does not affect Cobalt s infringement of the 722 patent. On February 27, 2006, the Company, Aventis and Cobalt agreed that, subject to certain conditions, within 38 days, all parties will submit a joint stipulation dismissing without prejudice the litigation before the U.S. District Court of Massachusetts.

Lupin Ltd. (Lupin) filed an ANDA with the FDA seeking permission to market a generic version of Altace® (Lupin s ANDA). In addition to its ANDA, Lupin filed a Paragraph IV certification challenging the validity and infringement of the 722 patent, and seeking to market its generic version of Altace® before expiration of the 722 patent. In July 2005, we filed civil actions for infringement of the 722 patent against Lupin in the U.S. District Courts for the District of Maryland and the Eastern District of Virginia. Pursuant to the Hatch-Waxman Act, the filing of the suit against Lupin provides us with an automatic stay of FDA approval of Lupin s ANDA for up to 30 months from no earlier than June 8, 2005. On February 1, 2006, the Maryland and Virginia cases were consolidated into a single action in the Eastern District of Virginia. Trial is currently scheduled to begin in that action on June 6, 2006.

We intend to vigorously enforce our rights under the 722 and 856 patents. If a generic version of Altace® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected. As of December 31, 2005, we had net intangible assets related to Altace® of $239.5 million. If a generic version of Altace® enters the market, the Company may have to write off a portion or all of the patent intangible assets and the other intangible assets associated with this product.

Eon Labs, Inc. (Eon Labs), CorePharma, LLC (CorePharma) and Mutual Pharmaceutical Co. (Mutual), Inc. have each filed an ANDA with the 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

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do not expire until December 3, 2021. Eon Labs and CorePharma have each filed Paragraph IV certifications against the 128 patent and the 102 patent alleging noninfringement and invalidity of these patents. Mutual has filed a Paragraph IV certification against the 102 patent alleging noninfringement and invalidity of that patent. A patent infringement suit was filed against Eon Labs on January 2, 2003 in the District Court for the Eastern District of New York; against CorePharma on March 7, 2003 in the District Court for the District of New Jersey (subsequently transferred to the District Court for the Eastern District of New York); and against Mutual on March 12, 2004 in the District Court for the Eastern District of Pennsylvania concerning their proposed 400 mg products. Additionally, we filed a separate suit against Eon Labs on December 17, 2004, in the District Court for the Eastern District of New York concerning its proposed 800 mg product. Pursuant to the Hatch-Waxman Act, the filing of the suit against CorePharma provided us with an automatic stay of FDA approval of CorePharma s ANDA for 30 months from no earlier than January 24, 2003. Also pursuant to the Hatch-Waxman Act, the filing of the suits against Eon Labs provided us with an automatic stay of FDA approval of Eon Labs ANDA for its proposed 400 mg and 800 mg products for 30 months from no earlier than November 18, 2002 and November 3, 2004, respectively. We intend to vigorously enforce our rights under the 128 and 102 patents to the full extent of the law.

On March 9, 2004, we 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. We believe that this decision is arbitrary, capricious, and inconsistent with the FDA s previous position on this issue. We 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. We concurrently filed a Petition for Stay of Action requesting the FDA to stay approval of any generic metaxalone products until the FDA has fully evaluated our Citizen Petition.

On March 12, 2004, the FDA sent a letter to us explaining that our proposed labeling revision, 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, we 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 our proposed labeling revision until the FDA has fully evaluated and ruled upon our Citizen Petition, as well as all comments submitted in response to that petition. Discussions with the FDA concerning appropriate labeling are ongoing. CorePharma, Mutual and we have filed responses and supplements to the pending Citizen Petition.

If our Citizen Petition is rejected, there is a substantial likelihood that a generic version of Skelaxin® will enter the market, and our business, financial condition, results of operations and cash flows could be materially adversely affected. In an attempt to mitigate this risk, we have entered into an agreement with a generic pharmaceutical company to launch an authorized generic of Skelaxin® in the event of generic competition. However, we cannot provide any assurance regarding the degree to which this strategy will be successful, if at all. As of December 31, 2005, we had net intangible assets related to Skelaxin® of $170.4 million. If demand for Skelaxin® declines below current expectations, we may have to write off a portion or all of these intangible assets.

Sicor Pharmaceuticals, Inc. (Sicor), a generic drug manufacturer located in Irvine California, filed an ANDA with the FDA seeking permission to market a generic version of Adenoscan®. U.S. Patent No. 5,070,877 (the 877 patent) is assigned to us and is listed in the FDA s Orange Book entry for Adenoscan®. Astellas Pharma US, Inc. (Astellas) is the exclusive licensee of certain rights under the 877 and has marketed Adenoscan® in the U.S. since 1995. A substantial portion of the revenues from our royalties segment is derived from Astellas from its net sales of Adenoscan®. Sicor has filed a Paragraph IV certification alleging invalidity of the 877 patent and non-infringement of certain claims of the 877 patent. We and Astellas filed suit against Sicor and its parents/affiliates Sicor, Inc., Teva Pharmaceuticals USA, Inc. (Teva) and Teva Pharmaceutical Industries, Ltd., on May 26, 2005, in the United States District Court for the District of Delaware to enforce our rights under the 877 patent. Pursuant to the Hatch-

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Waxman Act, the filing of that suit provides us an automatic stay of FDA approval of Sicor s ANDA for 30 months from no earlier than April 16, 2005. We do not expect trial to begin before February 2007. We intend to vigorously enforce our rights under the 877 patent. If a generic version of Adenoscan® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Teva filed an ANDA with the FDA seeking permission to market a generic version of Sonata®. In addition to its ANDA, Teva filed a Paragraph IV certification challenging the validity and enforceability of U.S. Patent 4,626,538 (the 538 patent) listed in the Orange Book which expires in June 2008. We filed suit against Teva in the United States District Court for the District of New Jersey to enforce our rights under the 538 patent. Pursuant to the Hatch-Waxman Act, our filing of that suit provides us an automatic stay of FDA approval of Teva s ANDA for 30 months from no earlier than June 21, 2005. We intend to vigorously enforce our rights under the 538 patent. As of December 31, 2005, we had net intangible assets related to Sonata® of $12.9 million. If a generic form of Sonata® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected.

We may not be successful in securing or maintaining proprietary patent protection for other of our products or for products and technologies we develop or license. In addition, our competitors may develop products similar to ours, including generic products, using methods and technologies that are beyond the scope of our intellectual property protection, which could reduce our sales.

We also rely upon trade secrets, unpatented proprietary know-how and continuing technological innovation in order to maintain our competitive position. We cannot assure you that others will not independently develop substantially equivalent proprietary technology and techniques or otherwise gain access to our trade secrets and technology, or that we can adequately protect our trade secrets and technology.

If we are unable to secure or enforce patent rights, trademarks, trade secrets or other intellectual property, our business, financial condition, results of operations and cash flows could be materially adversely affected.

We have entered into agreements with manufacturers and/or distributors of generic pharmaceutical products with whom we are presently engaged, or have been previously engaged in litigation, and these activities could subject us to claims that we have violated federal and/or state anti-trust laws.

We have negotiated and entered into a number of agreements with manufacturers and/or distributors of generic pharmaceutical products with whom we are presently engaged or have previously been engaged in litigation. Governmental and/or private parties may allege that these arrangements violate applicable state or federal anti-trust laws. If a court or other governmental body were to conclude that a violation of these laws had occurred, liability based on such a finding could be material and may adversely affect us.

We cannot assure you that we will be able to comply with the terms and conditions of our corporate integrity agreement with the Office of Inspector General of the United States Department of Health and Human Services.

In October 2005, as part of our settlement of the government pricing investigation of our company (see Item 3. Legal Proceedings, below), we entered into a five-year corporate integrity agreement (CIA) with the Office of Inspector General of the United States Department of Health and Human Services (HHS/ OIG). The purpose of the CIA, which applies to all of our U.S. subsidiaries and employees, is to promote compliance with the federal health care and procurement programs in which we participate, including the Medicaid Drug Rebate Program, the Medicare Program, the 340B Drug Pricing Program, and the Veterans Administration Pricing Program.

In addition to the challenges associated with complying with the regulations applicable to each of these programs (as discussed below), we are required, among other things, to keep in place our current compliance program, provide specified training to employees, retain an independent review organization to

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conduct periodic audits of our Medicaid Rebate and Medicare Average Sales Price calculations and our automated systems, processes, policies and practices related to government pricing calculations, and to provide periodic reports to HHS/ OIG.

Implementing the broad array of processes, policies, and procedures necessary to comply with the CIA has resulted, and is expected to continue to result, in a significant diversion of management s attention and resources and the payment of additional professional fees.

Failing to meet the CIA obligations could have serious consequences for us including stipulated monetary penalties for each instance of non-compliance. In addition, flagrant or repeated violations of the CIA could result in our being excluded from participating in government health care programs, which could have a material adverse effect on our business.

We are subject to the risk of additional litigation and regulatory proceedings or actions in connection with the restatement of prior period financial statements.

We previously restated our previously issued financial statements for the fiscal years 2002 and 2003, including interim periods in 2003, and the first two quarters of 2004. We may in the future be subject to class action suits, other litigation or regulatory proceedings or actions arising in relation to the restatement of our prior period financial statements. Any expenses incurred in connection with such a potential litigation or regulatory proceeding or action not covered by available insurance or any adverse resolution of this potential litigation or regulatory proceeding or action could have a material adverse effect on our business, results of operations, cash flows and financial condition. Further, any litigation or regulatory proceeding or action may be time-consuming and may distract our management from the conduct of our business.

We cannot assure you that we will be able to maintain effective internal control over financial reporting.

Under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules issued thereunder, management is required to conduct an evaluation of the effectiveness of our internal control over financial reporting as of each year-end. We are also required to include in our Annual Reports on Form 10-K a report on management s assessment of the effectiveness of our internal control over financial reporting. Our registered public accounting firm also issues an audit report on management s assessment and our internal control over financial reporting.

Management has concluded that our internal control over financial reporting was effective as of December 31, 2005 and that it provided reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements in accordance with generally accepted accounting principles. We cannot assure you that management will not identify one or more significant deficiencies or material weaknesses in our internal control over financial reporting during 2006 or thereafter, that the steps we take to address any significant deficiencies or material weaknesses will be successful, that a significant deficiency or material weakness will not result in material errors in our financial statements before it is remediated, that management will be able to complete its assessment of internal control over financial reporting in a timely fashion in 2006 or thereafter, or that management will be able to conclude on the basis of its evaluation that our internal control over financial reporting is effective as of the end of 2006 or a later period.

If we fail to maintain effective internal control over financial reporting, including adapting this control to changing conditions and requirements, such a failure could have a material adverse effect on our business and the value of our common stock.

If sales of our major products or royalty payments to us decrease, our results of operations could be materially adversely affected.

Altace®, Skelaxin®, Thrombin-JMI®, Levoxyl®, Sonata® and royalty revenues for the last twelve months ended December 31, 2005 accounted for 31.3%, 19.4%, 12.4%, 7.9%, 4.7% and 4.4% of our total

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revenues from continuing operations, respectively, or 80.1% in total. We believe that these sources of revenue may constitute a significant portion of our revenues for the foreseeable future. However, the agreements associated with some sources of royalty income may be terminated upon short notice and without cause or may be subject to substantial competition in the near future. Accordingly, any factor adversely affecting sales of any of these products or products for which we receive royalty payments could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Although we have an obligation to indemnify our officers and directors, we may not have sufficient insurance coverage available for this purpose and may be forced to pay these indemnification costs directly. We may not be able to maintain existing levels of coverage, which could make it difficult to attract or retain qualified directors and officers.

Our charter and bylaws require that we indemnify our directors and officers to the fullest extent provided by applicable Tennessee law. Although we have purchased liability insurance for our directors and officers to fund such obligations, if our insurance carrier should deny coverage, or if the indemnification costs exceed the insurance coverage, we would be forced to bear some or all of these indemnification costs directly, which could be substantial and may have a material adverse effect on our business, financial condition, results of operations and cash flows. If the cost of this insurance increases significantly, or if this insurance becomes unavailable, we may not be able to increase or maintain our levels of insurance coverage for our directors and officers, which could make it difficult to attract or retain qualified directors and officers.

We are required annually, or on an interim basis as needed, to review the carrying value of our intangible assets and goodwill for impairment. If events such as generic competition or inability to manufacture or obtain sufficient supply of product occur that cause the sales of our products to decline, the intangible asset value of any declining product could become impaired.

As of December 31, 2005, we had $1.1 billion of net intangible assets and goodwill. Intangible assets primarily include the net book value of various product rights, trademarks, patents and other intangible rights. If a change in circumstances causes us to lower our future sales forecast for a product, we may be required to write off a portion of the net book value of the intangible assets associated with that product. Any impairment of the net book value of any product or combination of products, depending on the size of the product or products, could result in a material adverse effect on our business, financial condition and results of operations. In evaluating goodwill for impairment, we estimate the fair value of our individual business reporting units on a discounted cash flow basis. In the event the value of an individual business reporting unit declines significantly, it could result in a non-cash impairment charge.

If we cannot implement our strategy to grow our business through increased sales, acquisitions, development and in-licensing, our business or competitive position in the pharmaceutical industry may suffer.

Our current strategy is to increase sales of our existing products and to enhance our competitive standing through acquisitions or in-licensing of products, either in development or previously approved by the FDA, that complement our business and enable us to promote and sell new products through existing marketing and distribution channels. Moreover, since we engage in limited proprietary research activity with respect to the development of new chemical entities, we rely heavily on purchasing or licensing products in development and FDA-approved products from other companies.

We are engaged in the development and licensing of new products. For example, we are engaged in the development of:

Remoxy[tm], an investigational drug for the treatment of severe to chronic pain;

binodenoson, a myocardial pharmacologic stress imaging agent;

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PT-141, an investigational new drug for the treatment of erectile dysfunction and female sexual dysfunction;

T-62, an investigational drug for the treatment of neuropathic pain;

MRE0094, an investigational drug for the topical treatment of chronic diabetic foot ulcers;

a new inhaler for Intal® using the alternative propellant HFA for which the FDA has issued an approvable letter;

a potential new formulation of metaxalone;

a novel formulation of ramipril for which an NDA is pending;

an Altace®/diuretic combination product; and

Vanquix™, a diazepam-filled auto-injector.

We compete with other pharmaceutical companies, including large pharmaceutical companies with financial, human and other resources substantially greater than ours, in the development and licensing of new products. We cannot assure you that we will be able to

engage in product life-cycle management to develop new indications and line extensions for existing and acquired products,

successfully develop, license or commercialize new products on a timely basis or at all,

continue to develop products already in development in a cost effective manner, or

obtain any FDA approvals necessary to successfully implement the strategies described above.

If we are not successful in the development or licensing of new products already in development, including the failure to obtain any necessary FDA approval, our business, financial condition, and results of operations could be materially adversely affected.

Further, other companies may license or develop products or may acquire technologies for the development of products that are the same as or similar to the products we have in development or that we license. Because there is rapid technological change in the industry and because many other companies may have more financial resources than we do, other companies may

develop or license their products more rapidly than we can,

complete any applicable regulatory approval process sooner than we can,

market or license their products before we can market or license our products, or

offer their newly developed or licensed products at prices lower than our prices,

and thereby have a negative impact on the sales of our existing, newly developed or licensed products. The inability to effect acquisitions or licenses of additional branded products in development and FDA-approved products could limit the overall growth of our business. Furthermore, even if we obtain rights to a pharmaceutical product or acquire a company, we may not be able to generate sales sufficient to create a profit or otherwise avoid a loss. Technological developments or the FDA s approval of new products or of new therapeutic indications for existing products may make our existing products or those products we are licensing or developing obsolete or may make them more difficult to market successfully, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

If we cannot integrate the business of companies or products we acquire, or appropriately and successfully manage and coordinate third-party collaborative development activities, our business may suffer.

The integration of acquisitions into our business of in-licensed or acquired assets or businesses, as well as the coordination and collaboration of development, sales and marketing efforts with third parties,

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requires significant management attention and may require the further expansion of our support personnel, sales force and other human resources. In order to manage our in-license and acquisition activity effectively, we must maintain adequate operational, financial and management information systems, integrate the systems that we acquire into our existing systems, and ensure that the acquired systems meet our standards for internal control over financial reporting. Our future success will also depend in part on our ability to hire, retain and motivate qualified employees to manage expanded operations efficiently and in accordance with applicable regulatory standards. If we cannot manage our third-party collaborations and integrate in-licensed and acquired assets successfully, or, if we do not establish and maintain an appropriate administrative, support and control infrastructure to support these activities, this could have a material adverse effect on our business, financial condition, results of operations and cash flows and on our ability to make the necessary certifications with respect to our internal controls.

We do not have proprietary protection for most of our branded pharmaceutical products, and our sales could suffer from competition by generic substitutes.

Although most of our revenue is generated by products not subject to competition from generic products, there is no proprietary protection for most of our branded pharmaceutical products, and generic substitutes for many of these products are sold by other pharmaceutical companies. Even our products that currently have no generic substitute could face generic competition if generics are developed by other companies and approved by the FDA. The entry of generic substitutes for any of our products could adversely affect our business, financial condition, results of operations and cash flows. In addition, governmental and other pressure to reduce pharmaceutical costs may result in physicians prescribing products for which there are generic substitutes. Also, our branded products for which there is no generic form available may face competition from different therapeutic agents used for the same indications for which our branded products are used. Increased competition from the sale of generic pharmaceutical products or from different therapeutic agents used for the same indications for which our branded products are used may cause a decrease in revenue from our branded products and could have a material adverse effect on our business, financial condition, results of operations and cash flows.

If we cannot sell our products in amounts greater than our minimum purchase requirements under some of our supply agreements or sell our products in accordance with our forecasts, our results of operations and cash flows may be adversely affected.

Some of our supply agreements or purchase orders, including those related to Altace® and Skelaxin®, require us to purchase certain minimum levels of active ingredients or finished goods. If we are unable to maintain market exclusivity for our products, if our product life-cycle management is not successful, if we fail to sell our products in accordance with the forecasts we develop as required by our supply agreements or if we do not terminate supply agreements at times that are optimal for us, we may incur losses in connection with the purchase commitments under the supply agreements or purchase orders. In the event we incur losses in connection with the purchase commitments under our supply agreements or purchase orders, there may be a material adverse effect upon our results of operations and cash flows.

Additionally, we purchase raw materials and some of our finished goods based on our forecast for sales of our products. We also manufacture many of our finished goods based on these forecasts. If we do not meet expected forecasts for sales, we could purchase inventory quantities in excess of expected demand. This purchase of excess inventory could have a material adverse effect on our results of operations and cash flows.

Any significant delays or difficulties in the manufacture of, or supply of materials for, our products may reduce our profit margins and revenues, limit the sales of our products, or harm our products reputations.

We manufacture many of our products in facilities we own and operate. These products include Altace®, Thrombin-JMI® and Levoxyl®, which together represented approximately 51.6% of our revenues for the last twelve months ended December 31, 2005. Many of our production processes are complex and

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require specialized and expensive equipment. If we are not in compliance with applicable regulations, the manufacture of our products could be delayed, halted or otherwise adversely affected. Any unforeseen delays or interruptions in our manufacturing operations may reduce our profit margins and revenues. In the event of an interruption, we may not be able to distribute our products as planned. Furthermore, growing demand for our products could exceed our ability to supply the demand. If such situations occur, it may be necessary for us to seek alternative manufacturers, which could adversely impact our ability to produce and distribute our products. We cannot assure you that we would be able to arrange for third parties to manufacture our products in a timely manner or at all. In addition, our manufacturing output may be interrupted by power outages, supply shortages, accidents, natural disasters or other disruptions. Even though we carry business interruption insurance policies, we may suffer losses as a result of business interruptions that exceed the coverage available under our insurance policies.

Many of our product lines, including Altace®, Skelaxin®, Sonata®, Intal®, Tilade®, Synercid® and Cortisporin®, are currently manufactured in part or entirely by third parties. Our dependence upon third parties for the manufacture of our products may adversely effect our profit margins or may result in unforeseen delays or other problems beyond our control. For example, if any of these third parties are not in compliance with applicable regulations, the manufacture of our products could be delayed, halted or otherwise adversely affected. If for any reason we are unable to obtain or retain third-party manufacturers on commercially acceptable terms, we may not be able to distribute our products as planned. If we encounter delays or difficulties with contract manufacturers in producing or packaging our products, the distribution, marketing and subsequent sales of these products would be adversely affected, and we may have to seek alternative sources of supply or abandon or sell product lines on unsatisfactory terms. We might not be able to enter into alternative supply arrangements at commercially acceptable rates, if at all. We also cannot assure you that the manufacturers we use will be able to provide us with sufficient quantities of our products or that the products supplied to us will meet our specifications.

We have begun construction of facilities to produce Bicillin® at our Rochester, Michigan location. The third-party manufacturer that produced Bicillin® for us closed its plant. If our inventory of Bicillin® is not sufficient to sustain demand during the period we are constructing our Bicillin® manufacturing facility, or if we experience delays in obtaining regulatory authorizations or experience production difficulties at our Bicillin® manufacturing facility, sales of this product may be reduced or the market for the product may be permanently diminished, either of which could have a material adverse effect on our business, financial condition, results of operations and cash flows. For the year ended December 31, 2005, net sales of Bicillin® were $54.0 million, representing 3.0% of our total revenues.

We are also in the process of transferring the manufacture of some of our other products that are currently manufactured by third parties to our manufacturing facilities. We expect to complete these transfers prior to the expiration of the agreements concerning supply of these products. However, we cannot assure you that we will complete the transfers prior to the expiration of the supply agreements, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We and third parties with whom we contract require a supply of quality raw materials and components to manufacture and package our pharmaceutical products. Currently, we and our third-party manufacturers rely on over 500 suppliers to deliver the necessary raw materials and components. Some of our contracts for the supply of raw materials have short durations, and there is no assurance that we will be able to secure extension of the terms of such agreements. If we or our third-party manufacturers are unable to obtain sufficient quantities of any of the raw materials or components required to produce and package our products, we may not be able to distribute our products as planned.

The occurrence of any of these events could result in significant backorders for our products, which could have a material adverse effect on our business, financial condition, results of operations and cash flows and could adversely affect our market share for the products and the reputation of our products.

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If third-party developers of some of our new product candidates and reformulated products fail to devote sufficient time and resources to our concerns, or if their performance is substandard or otherwise fails to comply with the terms of their agreements with us, or if we mismanage the development process, the introduction of new or reformulated products may not be successful.

We develop and manage the development of products and product line extensions through research and development and through contractual relationships with third parties that develop new products, including new product formulations, on our behalf. Our reliance on third parties for the development of some of our products exposes us to risks which could cause delays in the development of new products or reformulated products or could cause other problems beyond our control. These third-party developers

may not be successful in developing the products or product line extensions for us,

may face financial or business related difficulties which could make it difficult or impossible for them to continue business operations, or

may otherwise breach or terminate their agreements with us.

If any of these events occur, or we mismanage these processes or the third parties who perform services on our behalf, and we are unable to successfully develop these products and new product formulations by other means, our business, financial condition, results of operations and cash flows could be materially and adversely affected.

We are near maximum capacity at our Middleton, Wisconsin facility, which limits our ability to increase production of Thrombin-JMI®.

We are currently working to expand our production capacity for Thrombin-JMI®. We cannot assure you that our plans to expand our production capacity for Thrombin-JMI® will be successful and/or timely. If we cannot successfully and timely expand our production capacity for Thrombin-JMI®, our ability to increase production of Thrombin-JMI® will be limited, thereby limiting our unit sales growth for this product.

Wholesaler and distributor buying patterns and other factors may cause our quarterly results to fluctuate, and these fluctuations may adversely affect our short-term profitability.

Our results of operations, including, in particular, product sales revenue, may vary from quarter to quarter due to many factors. Sales to wholesalers and distributors represent a substantial portion of our total sales. Buying patterns of our wholesalers and distributors may vary from time to time. In the event wholesalers and distributors with whom we do business determine to limit their purchases of our products, sales of our products could be adversely affected. For example, in advance of an anticipated price increase, many of our customers may order pharmaceutical products in larger than normal quantities. The ordering of excess quantities in any quarter could cause sales of some of our branded pharmaceutical products to be lower in subsequent quarters than they would have been otherwise. As part of our ongoing efforts to facilitate improved management of wholesale inventory levels of our branded pharmaceutical products, we have entered into inventory management and data services agreements with each of our three key wholesale customers. These agreements provide wholesalers incentives to manage inventory levels and provide timely and accurate data with respect to inventory levels held, and valuable data regarding sales and marketplace activity. We rely on the timeliness and accuracy of the data that each customer provides to us on a regular basis pursuant to these agreements. If our wholesalers fail to provide us with timely and accurate data in accordance with the agreements, our estimates for certain reserves included in our financial statements could be materially and adversely affected.

Other factors that may affect quarterly results include expenditures related to the acquisition, sale and promotion of pharmaceutical products, a changing customer base, the availability and cost of raw materials, interruptions in supply by third-party manufacturers, new products introduced by us or our competitors, the mix of products we sell, sales and marketing expenditures, product recalls, competitive pricing pressures and general economic and industry conditions that may affect customer demand. We

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cannot assure you that we will be successful in maintaining or improving our profitability or avoiding losses in any future period.

The insolvency of any of our principal customers, who are wholesale pharmaceutical distributors, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Similar to other pharmaceutical companies, our principal customers are primarily wholesale pharmaceutical distributors. The wholesale distributor network for pharmaceutical products has in recent years been subject to increasing consolidation, which has increased our, and other industry participants , customer concentration. Accordingly, three key customers accounted for approximately 69% of our revenues and a significant portion of our accounts receivable for the fiscal year ended December 31, 2005. The insolvency of any of our principal customers could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our wholly owned subsidiary, King Research and Development, successor to Jones Pharma Incorporated, is a defendant in litigation which is currently being handled by its insurance carriers. Should this coverage be inadequate or subsequently denied or were we to lose some of these lawsuits, our results of operations could be adversely affected.

Our wholly owned subsidiary, King Research and Development, successor to Jones Pharma Incorporated, is a defendant in 143 multi-defendant lawsuits involving the manufacture and sale of dexfenfluramine, fenfluramine and phentermine, which is usually referred to as fen/phen. In 1996, Jones acted as a distributor of Obenix® a branded phentermine product. Jones also distributed a generic phentermine product. We believe that Jones phentermine products have been identified in less than 100 of the foregoing cases. The plaintiffs in these cases claim injury as a result of ingesting a combination of these weight-loss drugs. They seek 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 warranties and misrepresentation. These suits are filed in various jurisdictions throughout the United States, and in each of these suits King Research and Development is one of many defendants, including manufacturers and other distributors of these drugs. King Research and Development denies any liability incident to the distribution of Jones phentermine products and intends to pursue all defenses available to it. King Research and Development has tendered defense of these lawsuits to its insurance carriers for handling and they are currently defending King Research and Development in these suits. In the event that insurance coverage is inadequate to satisfy any resulting liability, King Research and Development will have to resume defense of these lawsuits and be responsible for the damages, if any, that are awarded against it.

Sales of Thrombin-JMI® may be affected by the perception of risks associated with some of the raw materials used in its manufacture; if we are unable to successfully develop purification procedures at our facilities that are in accordance with the FDA s expectations for biological products generally, the FDA could limit our ability to manufacture biological products at those facilities.

For the year ended December 31, 2005, our product Thrombin-JMI® accounted for 12.4% of our total revenues from continuing operations. The source material for Thrombin-JMI® comes from bovine plasma and lung tissue which has been certified by the United States Department of Agriculture for use in the manufacture of pharmaceutical products. Bovine-sourced materials, particularly those from outside the United States, may be of some concern because of potential transmission of bovine spongiform encephalopathy, or BSE. However, we have taken precautions to minimize the risks of contamination from BSE in our source materials. Our principal precaution is the use of bovine materials only from FDA-approved sources in the United States. Accordingly, all source animals used in our production of Thrombin-JMI® are of United States origin. Additionally, source animals used in production of Thrombin-JMI® are generally less than 18 months of age (BSE has not been identified in animals less than 30 months of age).

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We have two approved vendors as sources of supply of the bovine raw materials. Any interruption or delay in the supply of these materials could adversely affect the sales of Thrombin-JMI®. In addition to other actions taken by us and our vendors to minimize the risk of BSE, we are developing steps to further purify the material of other potential contaminants. We will continue surveillance of the source and believe that the risk of BSE contamination in the source materials for Thrombin-JMI® is very low. While we believe that our procedures and those of our vendor for the supply, testing and handling of the bovine material comply with all federal, state, and local regulations, we cannot eliminate the risk of contamination or injury from these materials. There are high levels of global public concern about BSE. Physicians could determine not to administer Thrombin-JMI® because of the perceived risk, which could adversely affect our sales of the product. Any injuries resulting from BSE contamination could expose us to extensive liability. Also, there is currently no alternative to the bovine-sourced materials for Thrombin-JMI®. If public concern for the risk of BSE infection in the United States should increase, the manufacture and sale of Thrombin-JMI® and our business, financial condition, results of operations and cash flows could be materially and adversely affected.

The FDA expects manufacturers of biological products to have validated processes capable of removing extraneous viral contaminants to a high level of assurance. As a result, many manufacturers of biologics are currently engaged in developing procedures to remove potential extraneous viral contaminants from their products. We are in the process of developing appropriate processing steps to achieve maximum assurance for the removal of potential extraneous viral contaminants from Thrombin-JMI®, which does not include BSE because it is not a viral contaminant. If we are not successful in gaining FDA approval for these processes, our ability to manufacture Thrombin-JMI® may be adversely affected. We cannot assure you that we will be successful in these efforts. Failure to obtain the FDA s approval for these procedures could have a material adverse effect on our business, financial condition, results of operations and cash flows.

On November 15, 2006, we may be required to repurchase our 2 3/4% Convertible Debentures due November 15, 2021, or we may elect to repurchase them sooner.

During the fourth quarter of 2001, we issued 2 3/4% Convertible Debentures due November 15, 2021 in an aggregate amount of $345.0 million. The price at which the debentures are convertible into common stock is $50.16, subject to adjustments spelled out in the documents governing the debentures. If the price of our stock has not reached that amount by November 15, 2006 and the debentures are not refinanced or repurchased, we may be required to repurchase all or a portion of the debentures representing the $345.0 million on November 15, 2006 if some or all of the holders of the debentures request that we repurchase their debentures. Alternatively, we may elect to repurchase some or all of the debentures, by negotiation with debenture holders, a buy-back program, or a tender offer, prior to November 15, 2006. We cannot assure you that a significant repurchase would not have a material adverse effect on our business, financial condition, results of operations, cash flows or liquidity.

A failure by Dey, L.P. to successfully market the EpiPen® auto-injector, or an increase in competition, could have a material adverse effect on our results of operations.

Dey, L.P. markets our EpiPen® auto-injector through a supply agreement with us that expires on December 31, 2015. Under the terms of the agreement, we grant Dey the exclusive right and license to market, distribute and sell EpiPen® worldwide. We understand that a new competitive product received FDA approval and entered the market in the third quarter of 2005. The new product, TwinJect® Auto-Injector (epinephrine) injection, is not a therapeutically equivalent product but has the same indications, same usage and the same route of delivery as EpiPen®. Users of EpiPen® would have to obtain a new prescription in order to substitute TwinJect®. The supply agreement with Dey includes minimum purchase requirements that are less than Dey s purchases in recent years. A failure by Dey to successfully market and distribute EpiPen® or an increase in competition could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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Our relationships with the U.S. Department of Defense and other government entities are subject to risks associated with doing business with the government.

All U.S. government contracts provide that they may be terminated for the convenience of the government as well as for default. Our Meridian Medical Technologies segment has pharmaceutical products that are presently sold primarily to the DoD under an Industrial Base Maintenance Contract (IBMC). The current IBMC expires in July 2006. Although we have reason to believe the DoD will renew the IBMC based on our relationship of many years, we cannot assure you that they will. In the event the DoD does not renew the IBMC, our business, financial condition, results of operations and cash flows could be materially adversely affected. Additionally, the unexpected termination of one or more of our significant government contracts could result in a material adverse effect on our business, financial condition, results of operations and cash flows. A surge capability provision allows for the coverage of defense mobilization requirements in the event of rapid military deployment. If this surge capability provision becomes operative, we may be required to devote more of our Meridian Medical Technologies segment manufacturing capacity to the production of products for the government which could result in less manufacturing capacity being devoted to products in this segment with higher profit margins.

Our supply contracts with the DoD are subject to post-award audit and potential price determination. These audits may include a review of our performance on the contract, our pricing practices, our cost structure and our compliance with applicable laws, regulations and standards. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while costs already reimbursed must be refunded. Therefore, a post-award audit or price redetermination could result in an adjustment to our revenues. From time to time the DoD makes claims for pricing adjustments with respect to completed contracts. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or disqualification from doing business with the government.

Other risks involved in government sales include the unpredictability in funding for various government programs and the risks associated with changes in procurement policies and priorities. Reductions in defense budgets may result in reductions in our revenues. We also provide our nerve agent antidote auto-injectors to a number of state agencies and local communities for homeland defense against chemical agent terrorist attacks. Changes in governmental and agency procurement policies and priorities may also result in a reduction in government funding for programs involving our auto-injectors. A loss in government funding of these programs could have a material adverse effect on our business, financial condition, results of operations and cash flows.

If we fail to comply with our reporting and payment obligations under the Medicaid rebate program or other governmental pricing programs, we could be subject to additional reimbursements, penalties, sanctions and fines which could have a material adverse effect on our business.

Medicaid reporting and payment obligations are highly complex and in certain respects ambiguous. If we fail to comply with these obligations, we could be subject to additional reimbursements, penalties, sanctions and fines which could have a material adverse effect on our business.

Since 2003, we have implemented new information technology systems that are intended to significantly enhance the accuracy of our calculations for estimating amounts due under Medicaid and other governmental pricing programs; however, our processes for these calculations and the judgments involved in making these calculations will continue to involve subjective decisions, and, as a result, these calculations will remain subject to the risk of errors.

If our operations were disrupted by a natural disaster or other catastrophic event, our business could be harmed.

A natural disaster, cyber-attack, terrorist attack, or other catastrophic event could result in a significant interruption of our normal business operations and have a material adverse effect on our business, financial conditions, results of operations and cash flows.

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For example, for efficiency, we rely upon a central distribution facility, located in Bristol, Tennessee. An interruption in operations at this facility could limit our ability to deliver our products to customers. Similarly, our business depends upon centralized electronic communication, analysis and recordkeeping systems. Damage to these systems could limit the normal operation of many aspects of our business, such as receipt and processing of orders, shipment of products to customers, internal communications and maintenance of financial and other records.

If we are unable to obtain approval of new HFA propellants for Intal® and Tilade®, our sales of these products could be adversely affected.

Under government regulations, chlorofluorocarbon compounds are being phased out because of environmental concerns. Our products Intal® and Tilade® currently use these compounds as propellants. The FDA has issued an approvable letter with respect to the new drug application, or NDA covering a new inhaler for Intal® using the alternative propellant HFA. The approvable letter provides that final approval of the NDA for Intal® HFA is subject to addressing certain FDA comments solely pertaining to the chemistry, manufacturing, and controls section of the NDA covering the product. In the event we cannot also obtain final approval for alternative propellants for Intal® and Tilade® before the final phase-out date for use of chlorofluorocarbon compounds or if we are unable to maintain an adequate supply of chlorofluorocarbon compounds for the production of these products prior to this date, our ability to market these products could be materially adversely affected, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

There are risks associated with either the continuation or termination of our agreement with Wyeth to co-promote Altace®.

Our revenues depend significantly upon the sale of Altace®. We have a Co-Promotion Agreement with Wyeth pursuant to which each company markets Altace® and shares in the revenues generated by its sale. The future success of this collaboration is uncertain. Factors that may affect the success of our collaboration with Wyeth include the following:

Wyeth may pursue alternative technologies or develop alternative products, either on its own or in collaboration with others, that may compete with Altace® or which could affect Wyeth s commitment to the collaboration;

Wyeth may pursue higher-priority programs or change the focus of its marketing programs, which could also affect its commitment to the collaboration; and

Wyeth may choose to devote fewer resources to the marketing of Altace®.

Our Co-Promotion Agreement with Wyeth results in our having less control over the promotion of Altace® than we would have in the absence of the Agreement. Further, we believe that we presently realize less operating income from the sale of Altace® than we would realize if the Agreement were terminated. Because of these factors, among others, as well as contractual disputes existing between Wyeth and us, we have sought, and may continue to seek, the termination of the Agreement.

Should Wyeth reduce the resources dedicated to the marketing of Altace®, or should the Co-Promotion Agreement be terminated, then we may need to expand our marketing capabilities, or enter into another collaborative arrangement, to ensure that appropriate sales and marketing resources are devoted to Altace®. Such efforts would require substantial time, effort and resources, and we may not be able to recruit and retain appropriate sales and marketing resources or enter into another collaborative arrangement. Any significant reduction in the sales and marketing resources devoted to Altace® could have a material adverse effect on sales of Altace® and on our business, financial conditions, results of operations and cash flows.

The loss of our key personnel or an inability to attract new personnel could harm our business.

We are highly dependent on the principal members of our management staff, the loss of whose services might impede the achievement of our strategic objectives. We cannot assure you that we will be

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able to attract and retain key personnel in sufficient numbers, or on acceptable terms, or with the skills which are necessary to support our growth and integration activities. The loss of the services of key personnel or the failure to attract such personnel could have a material adverse effect on us.

Our shareholder rights plan, charter and bylaws discourage unsolicited takeover proposals and could prevent shareholders from realizing a premium on their common stock.

We have a shareholder rights plan that may have the effect of discouraging unsolicited takeover proposals. The rights issued under the shareholder rights plan would cause substantial dilution to a person or group which attempts to acquire us on terms not approved in advance by our Board of Directors. In addition, our charter and bylaws contain provisions that may discourage unsolicited takeover proposals that shareholders may consider to be in their best interests. These provisions include

a classified Board of Directors;

the ability of our Board of Directors to designate the terms of and issue new series of preferred stock;

advance notice requirements for nominations for election to our Board of Directors; and

special voting requirements for the amendment of our charter and bylaws.

We are also subject to anti-takeover provisions under Tennessee laws, each of which could delay or prevent a change of control. Together these provisions and the rights plan may discourage transactions that otherwise could involve payment of a premium over prevailing market prices for our common stock.

Our stock price is volatile, which could result in substantial losses for our investors.

The trading price of our common stock is volatile. The stock market in general and the market for the securities of emerging pharmaceutical companies such as King, in particular, have experienced extreme volatility. Many factors contribute to this volatility, including

variations in our results of operations;

perceived risks and uncertainties concerning our business;

announcements of earnings;

developments in the governmental investigations or securities litigation;

the commencement of, or adverse developments in, any material litigation;

failure to meet or exceed our own projections for revenue, product sales and earnings per share;

failure to meet timelines for product development or other projections or forward-looking statements we may make to the public;

failure to meet or exceed security analysts financial projections for our company;

comments or recommendations made by securities analysts;

general market conditions;

perceptions about market conditions in the pharmaceutical industry;

announcements of technological innovations or the results of clinical trials or studies;

changes in marketing, product pricing and sales strategies or development of new products by us or our competitors;

changes in domestic or foreign governmental regulations or regulatory approval processes; and

announcements concerning regulatory compliance and government agency reviews.

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The volatility of our common stock imposes a greater risk of capital losses on our shareholders than would a less volatile stock. In addition, such volatility makes it difficult to ascribe a stable valuation to a shareholder s holdings of our common stock.

Risks Related to Our Industry

Failure to comply with laws and government regulations could adversely affect our ability to operate our business.

Virtually all aspects of our activities are regulated by federal and state statutes and government agencies. The manufacturing, processing, formulation, packaging, labeling, distribution and advertising of our products, and disposal of waste products arising from these activities, are subject to regulation by one or more federal agencies, including the FDA, the Drug Enforcement Agency, which we refer to as the DEA, the Federal Trade Commission, the Consumer Product Safety Commission, the U.S. Department of Agriculture, the Occupational Safety and Health Administration, and the Environmental Protection Agency (EPA,), as well as by foreign governments in countries where we distribute some of our products.

Noncompliance with applicable FDA policies or requirements could subject us to enforcement actions, such as suspensions of manufacturing or distribution, seizure of products, product recalls, fines, criminal penalties, injunctions, failure to approve pending drug product applications or withdrawal of product marketing approvals. Similar civil or criminal penalties could be imposed by other government agencies, such as the DEA, the EPA or various agencies of the states and localities in which our products are manufactured, sold or distributed, and could have ramifications for our contracts with government agencies such as the Department of Veterans Affairs or the Department of Defense. These enforcement actions could have a material adverse effect on our business, financial condition, results of operations and cash flows.

All manufacturers of human pharmaceutical products are subject to regulation by the FDA under the authority of the Food, Drug and Cosmetics Act (the FDC Act), or the Public Health Service Act (the PHS Act), or both. New drugs, as defined in the FDC Act, and new human biological drugs, as defined in the PHS Act, must be the subject of an FDA-approved new drug or biologic license application before they may be marketed in the United States. Some prescription and other drugs are not the subject of an approved marketing application but, rather, are marketed subject to the FDA s regulatory discretion and/or enforcement policies. Any change in the FDA s enforcement discretion and/or policies could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We manufacture some pharmaceutical products containing controlled substances and, therefore, are also subject to statutes and regulations enforced by the DEA and similar state agencies which impose security, record keeping, reporting and personnel requirements on us. Additionally, we manufacture biological drug products for human use and are subject to regulatory obligations as a result of these aspects of our business. There are additional FDA and other regulatory policies and requirements covering issues, such as advertising, commercially distributing, selling, sampling and reporting adverse events associated with our products, with which we must continuously comply. Noncompliance with any of these policies or requirements could result in enforcement actions which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The FDA has the authority and discretion to withdraw existing marketing approvals and to review the regulatory status of marketed products at any time. For example, the FDA may require an approved marketing application for any drug product marketed if new information reveals questions about a drug s safety or efficacy. All drugs must be manufactured in conformity with current Good Manufacturing Practices and drug products subject to an approved application must be manufactured, processed, packaged, held and labeled in accordance with information contained in the approved application.

While we believe that all of our currently marketed pharmaceutical products comply with FDA enforcement policies, have approval pending or have received the requisite agency approvals, our marketing

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is subject to challenge by the FDA at any time. Through various enforcement mechanisms, the FDA can ensure that noncomplying drugs are no longer marketed and that advertising and marketing materials and campaigns are in compliance with FDA regulations. In addition, modifications, enhancements, or changes in manufacturing sites of approved products are in many circumstances subject to additional FDA approvals which may or may not be received and which may be subject to a lengthy FDA review process. Our manufacturing facilities and those of our third-party manufacturers are continually subject to inspection by governmental agencies. Manufacturing operations could be interrupted or halted in any of those facilities if a government or regulatory authority is unsatisfied with the results of an inspection. Any interruptions of this type could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Under the Comprehensive Environmental Response, Compensation, and Liability Act, which we refer to as CERCLA, the EPA can impose liability for the entire cost of cleanup of contaminated properties upon each or any of the current and former site owners, site operators or parties who sent waste to the site, regardless of fault or the legality of the original disposal activity. In addition, many states, including Tennessee, Michigan, Wisconsin, Florida and Missouri, have statutes and regulatory authorities similar to CERCLA and to the EPA. We have entered into hazardous waste hauling agreements with licensed third parties to properly dispose of hazardous wastes. We cannot assure you that we will not be found liable under CERCLA or other applicable state statutes or regulations for the costs of undertaking a cleanup at a site to which our wastes were transported.

We cannot determine what effect changes in regulations, enforcement positions, statutes or legal interpretations, when and if promulgated, adopted or enacted, may have on our business in the future. These changes could, among other things, require modifications to our manufacturing methods or facilities, expanded or different labeling, new approvals, the recall, replacement or discontinuance of certain products, additional record keeping and expanded documentation of the properties of certain products and scientific substantiation. These changes, or new legislation, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

An increase in product liability claims or product recalls could harm our business.

We face an inherent business risk of exposure to product liability claims in the event that the use of our technologies or products is alleged to have resulted in adverse effects. These risks exist for products in clinical development and with respect to products that have received regulatory approval for commercial sale. While we have taken, and will continue to take, what we believe are appropriate precautions, we may not be able to avoid significant product liability exposure. We currently have product liability insurance in the amount of $80.0 million for aggregate annual claims including a $20.0 million self-insured retention; however, we cannot assure you that the level or breadth of any insurance coverage will be sufficient to cover fully all potential claims. Also, adequate insurance coverage might not be available in the future at acceptable costs, if at all. For example, we are now not able to obtain product liability insurance with respect to our products Menest®, Delestrogen® and Pitocin®, each a women s healthcare product. With respect to any product liability claims relating to these products, we could be responsible for any monetary damages awarded by any court or any voluntary monetary settlements. Significant judgments against us for product liability for which we have no insurance could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Product recalls or product field alerts may be issued at our discretion or at the discretion of the FDA, other government agencies or other companies having regulatory authority for pharmaceutical product sales. From time to time, we may recall products for various reasons, including failure of our products to maintain their stability through their expiration dates. Any recall or product field alert has the potential of damaging the reputation of the product. To date, these recalls have not been significant and have not had a material adverse effect on our business, financial condition, results of operations or cash flows. However, we cannot assure you that the number and significance of recalls will not increase in the future. Any significant recalls could materially affect our sales and the prescription trends for the products and damage

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the reputation of the products. In these cases, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Any reduction in reimbursement levels by managed care organizations or other third-party payors may have an adverse effect on our revenues.

Commercial success in producing, marketing and selling branded prescription pharmaceutical products depends, in part, on the availability of adequate reimbursement from third-party health care payors, such as the government, private health insurers and managed care organizations. Third-party payors are increasingly challenging whether to reimburse certain pharmaceutical products and medical services. For example, many managed health care organizations limit reimbursement of pharmaceutical products. These limits may take the form of formularies with differential co-pay tiers. The resulting competition among pharmaceutical companies to maximize their product reimbursement has generally reduced growth in average selling prices across the industry. We cannot assure you that our products will be appropriately reimbursed or included on the formulary lists of managed care organizations or that downward pricing pressures in the industry generally will not negatively impact our operations.

The commercial success of some of our products depends, in part, on whether third-party reimbursement is available for the use of our products by hospitals, clinics, doctors, pharmacies and patients. Third-party payors include state and federal governments, under programs such as Medicaid and other entitlement programs, as well as managed care organizations, private insurance plans and health maintenance organizations. Because of the growing size of the patient population covered by third party reimbursement, it is important to our business that we market our products to reimbursers that serve many of these organizations. Payment or reimbursement of only a portion of the cost of our prescription products could make our products less attractive, from a net-cost perspective, to patients, suppliers, retail pharmacies and prescribing physicians. Managed care organizations and other third-party payors try to negotiate the pricing of products to control their costs. Managed care organizations and pharmacy benefit managers typically develop reimbursement coverage strategies, including formularies, to reduce their cost for medications. Formularies can be based on the prices and/or therapeutic benefits of the available products. Due to their lower costs, generics receive more favorable reimbursement. The breadth of the products reimbursed varies considerably from one managed care organization to another, and many formularies include alternative and competitive products or therapies for treatment of particular medical conditions. Denial of a product from reimbursement can lead to its sharply reduced usage in the managed care organization patient population. If our products are not included within an adequate number of formularies or adequate reimbursement levels are not provided, or if those policies increasingly favor generic products, our market share and gross margins could be negatively affected, as could our overall business and financial condition.

We have addressed our contract relationship with managed care organizations in an effort to increase the attractiveness of reimbursements for our products. We take reserves for the estimated amounts of rebates we will pay to managed care organizations each quarter. Any increased usage of our products through Medicaid or managed care programs will increase the amount of rebates that we owe. We cannot assure you that our products will be included on the formulary lists of managed care organizations or that adverse reimbursement issues will not have a material effect on our business, financial condition, results of operations or cash flows.

If we fail to comply with the safe harbors provided under various federal and state laws, our business could be adversely affected.

We are subject to various federal and state laws pertaining to health care fraud and abuse, including anti-kickback laws and false claims laws. Anti-kickback laws make it illegal for a prescription drug manufacturer to solicit, offer, receive, or pay any remuneration in exchange for, or to include, the referral of business, including the purchase or prescription of a particular drug. The federal government has published regulations that identify safe harbors or exemptions for certain payment arrangements that do not violate the anti-kickback statutes. We seek to comply with these safe harbors. Due to the breadth of

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the statutory provisions and the absence of guidance in the form of regulations or court decisions addressing some of our practices, it is possible that our practices might be challenged under anti-kickback or similar laws. False claims laws prohibit anyone from knowingly (in the civil context), or knowingly and willfully (in the criminal context), presenting, or causing to be presented for payment to third-party payors (including Medicaid and Medicare) claims for reimbursed drugs or services that are false or fraudulent, claims for items or services not provided as claimed, or claims for medically unnecessary items or services. Our activities relating to the sale and marketing of our products are currently a subject of investigation by the Office of Inspector General, and as such they are likely to be subject to scrutiny under these laws.

Violations of fraud and abuse laws may be punishable by civil and/or criminal sanctions, including fines and civil monetary penalties, as well as the possibility of exclusion from federal health care programs, including Medicaid and Medicare. Any such violations could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In the future, the publication of negative results of studies or clinical trials may adversely impact our products.

From time to time studies or clinical trials on various aspects of pharmaceutical products are conducted by academics or others, including government agencies, the results of which, when published, may have dramatic effects on the markets for the pharmaceutical products that are the subject of the study. The publication of negative results of studies or clinical trials related to our products or the therapeutic areas in which our products compete could adversely affect our sales, the prescription trends for our products and the reputation of our products. In the event of the publication of negative results of studies or clinical trials related to our branded pharmaceutical products or the therapeutic areas in which our products compete, our business, financial condition, results of operations and cash flows could be materially adversely affected. Additionally, potential write-offs of the intangible assets associated with the affected products could materially adversely affect our results of operations.

New legislation or regulatory proposals may adversely affect our revenues.

A number of legislative and regulatory proposals aimed at changing the health care system, including the cost of prescription products, importation and reimportation of prescription products from countries outside the United States and changes in the levels at which pharmaceutical companies are reimbursed for sales of their products, have been proposed. While we cannot predict when or whether any of these proposals will be adopted or the effect these proposals may have on our business, these proposals, as well as the adoption of any proposal, may exacerbate industry-wide pricing pressures and could have a material adverse effect on our business, financial condition, results of operations and cash flows. For example, in 2000, Congress directed the FDA to adopt regulations allowing the reimportation of approved drugs originally manufactured in the United States back into the United States from other countries where the drugs were sold at a lower price. Although the Secretary of Health and Human Services has refused to implement this directive, in July 2003 the House of Representatives passed a similar bill that does not require the Secretary of Health and Human Services to act. The reimportation bills have not yet resulted in any new laws or regulations; however, these and other initiatives could decrease the price we receive for our products. Additionally, sales of our products in the United States could be adversely affected by the importation of products that some may deem to be equivalent to ours that are manufactured by others and are available outside the United States. Many States have implemented or are in the process of implementing regulations requiring pharmaceutical companies to provide them with certain marketing and pricing information. While we intend to comply with these regulations, we are unable at this time to predict or estimate the effect of these regulations, if any.

Changes in the Medicare, Medicaid or other governmental programs or the amounts paid by those programs for our services may adversely affect our earnings. These programs are highly regulated and subject to frequent and substantial changes and cost containment measures. In recent years, changes in these programs have limited and reduced reimbursement to providers. The Medicare Prescription Drug, Improvement and Modernization Act of 2003, creates a voluntary prescription drug benefit under the

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Social Security Act, which we refer to as Medicare Drug Benefit. Beginning in 2006, Medicare beneficiaries entitled to Part A or enrolled in Part B, as well as certain other Medicare enrollees, are eligible for the Medicare Drug Benefit. Regulations implementing the Medicare Drug Benefit were published January 28, 2005. The Medicare Drug Act requires that the Federal Trade Commission conduct a study and make recommendations regarding additional legislation that may be needed concerning the Medicare Drug Benefit. We are unable at this time to predict or estimate the financial effect of this new legislation.

The pharmaceutical industry is highly competitive, and other companies in our industry have much greater resources than we do.

In our industry, comparatively smaller pharmaceutical companies like us compete with large, global pharmaceutical companies with substantially greater financial resources for the acquisition of products in development, currently marketed products, technologies and companies. We cannot assure you that

- we will be able to continue to acquire commercially attractive pharmaceutical products, companies or technologies;
- additional competitors will not enter the market; or
- competition for acquisition of products in development, currently marketed products, companies and technologies will not have a material adverse effect on our business, financial condition and results of operations.

We also compete with pharmaceutical companies in marketing and selling pharmaceutical products. The selling prices of pharmaceutical products typically decline as competition increases. Further, other products now in use, developed or acquired by other pharmaceutical companies may be more effective or offered at lower prices than our current or future products. Competitors may also be able to complete the regulatory process sooner and, therefore, may begin to market their products in advance of ours. We believe that competition for sales of our products will continue to be based primarily on product efficacy, safety, reliability, availability and price.

Competition for Acquisitions and In-License Opportunities. We compete with other pharmaceutical companies for product and product line acquisitions and in-license opportunities. These competitors include Biovail Corporation, Forest Laboratories, Inc., Medicis Pharmaceutical Corporation, Shire Pharmaceuticals Group plc, Watson Pharmaceuticals, Inc., Wyeth, Pfizer, Inc., Bristol Myers Squibb, Sanofi Aventis, GlaxoSmithKline and other companies which either in-license pharmaceutical product opportunities or compounds, or acquire branded pharmaceutical products and product lines, including those in development, from other biotech, pharmaceutical or bio-pharma companies. We cannot assure you that

- we will be successful in the acquisition, or in-license of commercially attractive pharmaceutical opportunities, compounds, products, companies or technologies,
- additional competitors will not enter the market,
- competition for acquisition and in-license of pharmaceutical opportunities, compounds or products, including products in development, currently marketed products, companies and technologies will not have a material adverse effect on our business, financial condition and results of operations, or
- we will be successful in bringing compounds, products in development or other opportunities to commercial success.

Product Competition. Additionally, since our currently marketed products are generally established and commonly sold, they are subject to competition from products with similar qualities.

Our largest product Altace® competes in a very competitive and highly genericized market with other cardiovascular therapies.

Our product Skelaxin® competes in a highly genericized market with other muscle relaxants.

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Our product Sonata® competes with other insomnia treatments in a highly competitive market.

Our product Levoxyl® competes in a competitive and highly genericized market with other levothyroxine sodium products.

We anticipate competition from both bovine and recombinant human thrombin for our product Thrombin-JMI® in the near future.

We intend to market these products aggressively by, among other things:

- detailing and sampling to the primary prescribing physician groups, and
- sponsoring physician symposia, including continuing medical education seminars.

Many of our branded pharmaceutical products have either a strong market niche or competitive position. Some of our branded pharmaceutical products face competition from generic substitutes.

The manufacturers of generic products typically do not bear the related research and development costs and, consequently, are able to offer such products at considerably lower prices than the branded equivalents. We cannot assure you that any of our products will remain exclusive without generic competition, or maintain their market share, gross margins and cash flows as a result of these efforts, the failure of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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, references to assumptions. These statements are contained in the Business, Risk Factors, and Management s Discussion and Analysis of Financial Condition and Results of Operations sections, as well as other sections of this report.

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

- the future potential of, including anticipated net sales and prescription trends for our branded pharmaceutical products, particularly Altace®, Skelaxin®, Thrombin-JMI®, Sonata® and Levoxyl®;
- expectations regarding the enforceability and effectiveness of product-related patents, including in particular patents related to Altace®, Skelaxin®, Sonata® and Adenoscan®;
- expected trends and projections with respect to particular products, reportable segment and income and expense line items;
- the timeliness and accuracy of wholesale inventory data provided by our customers;
- the adequacy of our liquidity and capital resources;
- anticipated capital expenditures;
- the development, approval and successful commercialization of Remoxy™, an investigational drug for the treatment of moderate-to-severe chronic pain; binodenoson, our next generation cardiac pharmacologic stress-imaging agent; PT-141, an investigational new drug for the treatment of erectile dysfunction and female sexual dysfunction; T-62, an investigational drug for the treatment of neuropathic pain; MRE0094, an investigational drug for the topical treatment of chronic diabetic foot ulcers; the development of a new formulation of Skelaxin®; pre-clinical programs; and product life-cycle development projects;

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the development, approval and successful commercialization of a diazepam-filled auto-injector, new inhaler for Intal® and Tilade® using the alternative propellant HFA, and an Altace®/diuretic combination product;

our successful execution of our growth strategies;

anticipated developments and expansions of our business;

our plans for the manufacture of some of our products, including but not limited to, the anticipated expansion of our manufacturing capacity for Thrombin-JMI®;

anticipated increases in sales of acquired products or royalty revenues;

the success of our Co-Promotion Agreement with Wyeth;

the high cost and uncertainty of research, clinical trials and other development activities involving pharmaceutical products;

the development of product line extensions;

the unpredictability of the duration or future findings and determinations of the FDA, including the pending applications related to our diazepam-filled auto-injector and a new Intal® inhaler formulation utilizing HFA, and other regulatory agencies worldwide;

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

the intent, belief 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 the outcome of various pending legal proceedings including the Altace® and Skelaxin® patent challenges, the SEC and Office of Inspector General investigations, other possible governmental investigations, securities litigation, and other legal proceedings described in this report; and

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

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 1B. ***Unresolved Staff Comments***

Not applicable.

Item 2. ***Properties***

The location and business segments served by our primary facilities are as follows:

Location	Business Segment(s)
Bristol, Tennessee	Branded Pharmaceuticals
Rochester, Michigan	Branded Pharmaceuticals and Contract Manufacturing
St. Louis, Missouri	Meridian Medical Technologies

St. Petersburg, Florida	Branded Pharmaceuticals
Middleton, Wisconsin	Branded Pharmaceuticals

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We own each of these primary facilities, with the exception of that portion of the facilities in St. Louis, Missouri that we acquired upon our acquisition of Meridian, which is leased. For information regarding production capacity and extent of utilization, please see Item 1, Manufacturing .

The Bristol, Rochester, and St. Louis owned facilities are pledged as collateral for our senior secured revolving credit facility dated April 23, 2002.

Our corporate headquarters and centralized distribution center are located in Bristol, Tennessee. We consider our properties to be generally in good condition, well maintained, and generally suitable and adequate to carry on our business.

Item 3. ***Legal Proceedings***

Settlement of Governmental Pricing Investigation

On October 31, 2005, we entered into (i) a definitive settlement agreement with the United States of America, acting through the United States Department of Justice and the United States Attorney s Office for the Eastern District of Pennsylvania and on behalf of the Office of Inspector General of the United States Department of Health and Human Services (HHS/ OIG) and the Department of Veterans Affairs, to resolve the governmental investigations related to our underpayment of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002 (the Federal Settlement Agreement), and (ii) similar settlement agreements with 48 states and the District of Columbia (collectively, the State Settlement Agreements , and together with the Federal Settlement Agreement, the Settlement Agreements). We have agreed to a settlement with the remaining state on substantially the same terms as the other state settlements, and we currently expect to enter into a definitive settlement agreement with that state before the end of the first quarter of 2006. Consummation of the Federal Settlement Agreement and some State Settlement Agreements is or was subject to court approval. On February 24, 2006, the United States District Court for the Eastern District of Pennsylvania (District Court) approved the Federal Settlement Agreement. All interested parties, including King, the individual purportedly acting as a relator under the False Claims Act and the affected states, have requested that the District Court approve the State Settlement Agreements that require court approval.

Pursuant to the Settlement Agreements, we agreed to pay a total of approximately $124.1 million (the Settlement Amount) and interest on the Settlement Amount at the rate of 3.75% from July 1, 2005 to the date of consummation of the settlement. We have further agreed to pay, subject to certain conditions, (i) legal fees relating to the settlement in the amount of approximately $0.8 million, and (ii) approximately $1.0 million in settlement costs. The Settlement Amount includes approximately $50.6 million for payment to 49 states and the District of Columbia. The Settlement Amount includes approximately $63.7 million representing the amount of underpayments to Medicaid and other governmental pricing programs from 1994 to 2002 and approximately $60.4 million to cover interest, penalties and other costs.

On March 2, 2006, we paid approximately $126.9 million, comprising the Settlement Amount and accrued interest under our Settlement Agreements with the United States and the 48 states and the District of Columbia. We have agreed to pay approximately $0.4 million to the remaining state. We currently expect to make this payment and the other remaining payments by the end of the first quarter of 2006.

Certain decisions of the District Court relating to the relator s dispute with certain states over a potential share award remain subject to appeal. Any share award would be paid solely by the government and would not affect the amount we are required to pay pursuant to the settlement. Consequently, we believe the reversal of any such decision or decisions would not have a material effect on us.

In addition to the Settlement Agreements, we have entered into a five-year corporate integrity agreement with HHS/ OIG (the Corporate Integrity Agreement) pursuant to which we are required, among other things, to keep in place our current compliance program, to provide periodic reports to HHS/ OIG and to submit to audits relating to our Medicaid rebate calculations.

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We accrued in prior years a total of $130.4 million in respect of our estimated underpayments to Medicaid and other governmental pricing programs and estimated settlement costs with all relevant governmental parties, which sum is classified as restricted cash and an accrued expense on our balance sheet. This sum is sufficient to cover the full cost of all sums owed the federal and state governments pursuant to the Settlement Agreements, together with related obligations to reimburse the expenses of some of the parties.

The previously disclosed claim seeking damages from us because of alleged retaliatory actions against the relator was dismissed with prejudice on January 31, 2006.

The Settlement Agreements will not resolve any of the previously disclosed civil suits that are pending against us and related individuals and entities discussed in the section Securities and ERISA Litigation below.

The foregoing description of the settlement, the Settlement Agreements and the Corporate Integrity Agreement is qualified in its entirety by the Company s Current Report on Form 8-K filed November 4, 2005, which is incorporated herein by reference.

SEC Investigation

As previously reported, the SEC has also been conducting an investigation relating to our underpayments to governmental programs, as well as into our previously disclosed errors relating to reserves for product returns. While the SEC s investigation is continuing with respect to the product returns issue, the Staff of the SEC has advised us that it has determined not to recommend enforcement action against us with respect to the aforementioned governmental pricing matter. The Staff of the SEC notified us of this determination pursuant to the final paragraph of Securities Act Release 5310. Although the SEC could still consider charges against individuals in connection with the governmental pricing matter, we do not believe that any governmental unit with authority to assert criminal charges is considering any charges of that kind.

We continue to cooperate with the SEC s ongoing investigation. Based on all information currently available to us, we do not anticipate that the results of the SEC s ongoing investigation will have a material adverse effect on us, including by virtue of any obligations to indemnify current or former officers and directors.

Securities and ERISA Litigation

Subsequent to the announcement of the SEC investigation described above, beginning in March 2003, 22 purported class action complaints were filed by holders of our securities against us, our directors, former directors, our executive officers, former executive officers, a subsidiary, and a former director of the subsidiary in the United States District Court for the Eastern District of Tennessee, alleging violations of the Securities Act of 1933 and/or the Securities Exchange Act of 1934, in connection with our underpayment of rebates owed to Medicaid and other governmental pricing programs, and certain transactions between us and the Benevolent Fund. These 22 complaints have been consolidated in the United States District Court for the Eastern District of Tennessee. In addition, holders of our securities filed two class action complaints alleging violations of the Securities Act of 1933 in Tennessee state court. We removed these two cases to the United States District Court for the Eastern District of Tennessee, where these two cases were consolidated with the other class actions. The district court has appointed lead plaintiffs in the consolidated action, and those lead plaintiffs filed a consolidated amended complaint on October 21, 2003 alleging that we, through some of our executive officers, former executive officers, directors, and former directors, made false or misleading statements concerning our business, financial condition, and results of operations during periods beginning February 16, 1999 and continuing until March 10, 2003. Plaintiffs in the consolidated action have also named the underwriters of our November 2001 public offering as defendants. We and other defendants filed motions to dismiss the consolidated amended complaint.

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On August 12, 2004, the United States District Court for the Eastern District of Tennessee ruled on defendants motions to dismiss. The Court dismissed all claims as to Jones Pharma Incorporated, a predecessor to one of our wholly owned subsidiaries, King Pharmaceuticals Research and Development, Inc., and as to defendants Dennis Jones and Henry Richards. The Court also dismissed certain claims as to five other individual defendants. The Court denied the motions to dismiss in all other respects. Following the Court s ruling, on September 20, 2004, we and the other remaining defendants filed answers to plaintiffs consolidated amended complaint. Discovery in this action has commenced. The Court has set a trial date of April 10, 2007.

We have estimated a probable loss contingency for the class action lawsuit described above. We believe this loss contingency will be paid on behalf of us by our insurance carriers. Accordingly, as of December 31, 2005, we have recorded a liability and a receivable for this amount, classified in accrued expenses and prepaid and other current assets, respectively, in our consolidated financial statement.

Beginning in March 2003, four purported shareholder derivative complaints were also filed in Tennessee state court alleging a breach of fiduciary duty, among other things, by some of our current and former officers and directors, with respect to the same events at issue in the federal securities litigation described above. These cases have been consolidated, and on October 3, 2003, plaintiffs filed a consolidated amended complaint. On November 17, 2003, defendants filed a motion to dismiss or stay the consolidated amended complaint. The court denied the motion to dismiss, but granted a stay of proceedings. On October 11, 2004, the court lifted the stay to permit plaintiffs to file a further amended complaint adding class action claims related to our then-anticipated merger with Mylan Laboratories, Inc. On October 26, 2004, defendants filed a partial answer to the further amended complaint, and moved to dismiss the newly-added claims. Following the termination of the Mylan merger agreement, plaintiffs voluntarily dismissed these claims. Discovery with respect to the remaining claims in the case has commenced. No trial date has been set.

Beginning in March 2003, three purported shareholder derivative complaints were likewise filed in Tennessee federal court, asserting claims similar to those alleged in the state derivative litigation. These cases have been consolidated, and on December 2, 2003 plaintiffs filed a consolidated amended complaint. On March 9, 2004, the court entered an order indefinitely staying these cases in favor of the state derivative action.

In August 2004, a separate class action lawsuit was filed in Tennessee state court, asserting claims solely with respect to our then-anticipated merger with Mylan Laboratories. Defendants filed a motion to dismiss the case on November 30, 2004, which remains pending. We believe that the claims in this case are moot following termination of the Mylan merger agreement.

Additionally, a class action complaint was filed in the United States District Court for the Eastern District of Tennessee under the Employee Retirement Income Security Act (ERISA). As amended, the complaint alleges that we and certain of our executive officers, former executive officers, directors, former directors and an employee violated fiduciary duties that they allegedly owed our 401(k) Retirement Savings Plan s participants and beneficiaries under ERISA. The allegations underlying this action are similar in many respects to those in the class action litigation described above. The defendants filed a motion to dismiss the ERISA action on March 5, 2004. The District Court Judge referred the motion to a Magistrate Judge for a report and recommendation. On December 8, 2004, the Magistrate Judge held a hearing on this motion, and, on December 10, 2004, he recommended that the District Court Judge dismiss the action. The District Court Judge accepted the recommendation and dismissed the case on February 4, 2005. The plaintiffs have not appealed this decision, and the deadline for filing any appeal has now passed.

We are unable currently to predict the outcome or to reasonably estimate the range of potential loss, if any, except as noted above, in the pending litigation. If we were not to prevail in the pending litigation, or if any governmental sanctions are imposed in excess of those described above, neither of which we can predict or reasonably estimate at this time, our business, financial condition, results of operations and cash

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flows could be materially adversely affected. Responding to the government investigations and defending us in the pending litigation has resulted, and is expected to continue to result, in a significant diversion of management s attention and resources and the payment of additional professional fees.

Altace® Patent Challenge

Cobalt Pharmaceuticals, Inc. (Cobalt) filed an ANDA with the FDA seeking permission to market a generic version of Altace®. The following U.S. patents are listed for Altace® in the FDA s *Approved Drug Products with Therapeutic Equivalence Evaluations,* which is known as the Orange Book : U.S. Patent No. 5,061,722, the (722 patent), a composition-of-matter patent related to Altace®, and U.S. Patent No. 5,403,856, the (856 patent), a method-of-use patent related to Altace®, with expiration dates of October 2008 and April 2012, respectively. Under the Hatch-Waxman Act, any generic manufacturer may file an ANDA with Paragraph IV certification challenging the validity or infringement of a patent listed in the FDA s Orange Book four years after the pioneer company obtains approval of its NDA. Cobalt filed a Paragraph IV certification alleging invalidity of the 722 patent, and Aventis and the Company filed suit on March 14, 2003 in the District Court for the District of Massachusetts to enforce our rights under that patent. Pursuant to the Hatch-Waxman Act, the filing of that suit provided us an automatic stay of FDA approval of Cobalt s ANDA for 30 months from no earlier than February 5, 2003. That 30 month stay expired in August 2005 and on October 24, 2005, the FDA granted final approval of Cobalt s ANDA. In March 2004, Cobalt stipulated to infringement of the 722 patent. Subsequent to filing our original complaint, we amended our complaint to add an allegation of infringement of the 856 patent. The 856 patent covers one of Altaces three indications for use. In response to the amended complaint, Cobalt informed the FDA that it no longer seeks approval to market its proposed product for the indication covered by the 856 patent. On this basis, the court granted Cobalt summary judgment of non-infringement of the 856 patent. The court s decision does not affect Cobalt s infringement of the 722 patent. On February 27, 2006, the Company, Aventis and Cobalt agreed that, subject to certain conditions, within 38 days, all parties will submit a joint stipulation dismissing without prejudice the litigation before the U.S. District Court of Massachusetts.

Lupin Ltd. (Lupin) filed an ANDA with the FDA seeking permission to market a generic version of Altace® (Lupin s ANDA). In addition to its ANDA, Lupin filed a Paragraph IV certification challenging the validity and infringement of the 722 patent, and seeking to market its generic version of Altace® before expiration of the 722 patent. In July 2005, we filed civil actions for infringement of the 722 patent against Lupin in the U.S. District Courts for the District of Maryland and the Eastern District of Virginia. Pursuant to the Hatch-Waxman Act, the filing of the suit against Lupin provides us with an automatic stay of FDA approval of Lupin s ANDA for up to 30 months from no earlier than June 8, 2005. On February 1, 2006, the Maryland and Virginia cases were consolidated into a single action in the Eastern District of Virginia. Trial is currently scheduled to begin in that action on June 6, 2006.

We intend to vigorously enforce our rights under the 722 and 856 patents. If a generic version of Altace® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected. As of December 31, 2005, we had net intangible assets related to Altace® of $239.5 million.

Skelaxin® Patent Challenge

Eon Labs, Inc. (Eon Labs), CorePharma, LLC (CorePharma) and Mutual Pharmaceutical Company (Mutual) have each filed an ANDA with the 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 have each filed Paragraph IV certifications alleging noninfringement and invalidity of the 128 and 102 patents. Mutual has filed a Paragraph IV certification alleging noninfringement and invalidity of the 102 patent. We filed a patent infringement suit against Eon Labs on January 2, 2003 in the District Court for the Eastern District

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of New York, and against CorePharma on March 7, 2003 in the District Court for the District of New Jersey (subsequently transferred to the District Court for the Eastern District of New York), as well as against Mutual on March 12, 2004 in the District Court for the Eastern District of Pennsylvania concerning their proposed 400 mg products. Additionally, we filed a separate suit against Eon Labs on December 17, 2004 in the District Court for the Eastern District of New York, concerning its proposed 800 mg product. Pursuant to the Hatch-Waxman Act, our filing of the suit against CorePharma provided us with an automatic stay of FDA approval of CorePharma s ANDA for 30 months from no earlier than January 24, 2003. Also pursuant to the Hatch-Waxman Act, the filing of the suits against Eon Labs provided us with an automatic stay of FDA approval of Eon Labs ANDA for its proposed 400 mg and 800 mg products for 30 months from no earlier than November 18, 2002 and November 3, 2004, respectively. We intend to vigorously enforce our rights under the 128 and 102 patents to the full extent of the law.

On March 9, 2004, we received a copy of a letter from the FDA to all ANDA applicants for Skelaxin® stating that use listed in the FDA s Orange Book for the 128 patent may be deleted from the ANDA applicants product labeling. We believe that this decision is arbitrary, capricious, and inconsistent with the FDA s previous position on this issue. We 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, to require generic applicants to submit Paragraph IV certifications for the 128 patent, and to prohibit the removal of information corresponding to the use listed in the FDA s Orange Book. We concurrently filed a Petition for Stay of Action requesting the FDA to stay approval of any generic metaxalone products until the FDA has fully evaluated our Citizen Petition.

On March 12, 2004, the FDA sent a letter to us explaining that our proposed labeling revision, 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, we 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 our proposed labeling revision until the FDA has fully evaluated and ruled upon our Citizen Petition, as well as upon all comments submitted in response to that petition. Discussions with the FDA concerning appropriate labeling are ongoing. CorePharma, Mutual and we have filed responses and supplements to our pending Citizen Petition.

If our Citizen Petition is rejected, there is a substantial likelihood that a generic version of Skelaxin® will enter the market and our business, financial condition, results of operations and cash flows could be materially adversely affected. As of December 31, 2005, we had net intangible assets related to Skelaxin® of $170.4 million. We have entered into an agreement with a generic pharmaceutical company to launch an authorized generic of Skelaxin® in the event we face generic competition for Skelaxin®. However, we cannot assure to what extent this strategy will be successful.

Sonata® Patent Challenge

Teva Pharmaceuticals USA, Inc. (Teva) filed an ANDA with the FDA seeking permission to market a generic version of Sonata® in 5 mg and 10 mg dosages. In addition to its ANDA, Teva filed a Paragraph IV certification challenging the enforceability of U.S. Patent 4,626,538 (the 538 patent) listed in the FDA s Orange Book which expires in June 2008. We filed suit against Teva in the United States District Court for the District of New Jersey to enforce our rights under the 538 patent. Pursuant to the Hatch-Waxman Act, our filing of that suit provides us an automatic stay of FDA approval of Teva s ANDA for 30 months from no earlier than June 21, 2005. We intend to vigorously enforce our rights under the 538 patent. If a generic form of Sonata® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected. As of December 31, 2005, we had net intangible assets related to Sonata® of $12.9 million.

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Adenoscan® Patent Challenge

Sicor Pharmaceuticals, Inc. (Sicor), a generic drug manufacturer located in Irvine California, filed an ANDA with the FDA seeking permission to market a generic version of Adenoscan®. U.S. Patent No. 5,070,877 (the 877 patent) is assigned to us and is listed in the FDA s Orange Book entry for Adenoscan®. Astellas Pharma US, Inc. (Astellas) is our exclusive licensee of certain rights under the 877 patent and has marketed Adenoscan® in the U.S. since 1995. Sicor Pharma has filed a Paragraph IV certification alleging invalidity of the 877 patent and non-infringement of certain claims of the 877 patent. We and Astellas filed suit against Sicor and its parents/affiliates Sicor, Inc., Teva and Teva Pharmaceutical Industries, Ltd., on May 26, 2005, in the United States District Court for the District of Delaware to enforce our rights under the 877 patent. Pursuant to the Hatch-Waxman Act, the filing of that suit provides us with an automatic stay of FDA approval of Sicor s ANDA for 30 months from no earlier than April 16, 2005. We intend to vigorously enforce our rights under the 877 patent. If a generic version of Adenoscan® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Prefest® Patent Challenge

In 2003, Barr Laboratories, Inc. (Barr) filed an ANDA with the FDA seeking permission to market a generic version of Prefest®. On October 15, 2003, we received notice of Barr s Paragraph IV certification, which alleged noninfringement and invalidity of two patents, the 995 patent and the 573 patent. On November 26, 2003, we filed a complaint against Barr in the Southern District of New York for infringement of the 995 and 573 patents. On November 22, 2004, we sold all of our rights in Prefest® for approximately $15.0 million. As a result of this transaction, the lawsuit was dismissed on January 11, 2005.

Thimerosal/ Vaccine Related Litigation

We and Parkedale Pharmaceuticals, Inc., a wholly owned subsidiary of ours, have been named as defendants in lawsuits filed in California and Illinois, along with other pharmaceutical companies that have manufactured or sold products containing the mercury-based preservative, thimerosal.

In these cases, the plaintiffs attempted to link the receipt of the mercury-based products to neurological defects. The plaintiffs claim unfair business practices, fraudulent misrepresentations, negligent misrepresentations, and breach of implied warranty, which are all arguments premised on the idea that the defendants promoted products without any reference to the toxic hazards and potential public health ramifications resulting from the mercury-containing preservative. The plaintiffs also allege that the defendants knew of the dangerous propensities of thimerosal in their products.

Our product liability insurance carrier has been given proper notice of all of these matters and defense counsel is vigorously defending our interests. We have filed motions to dismiss due, among other things, to lack of product identity in the plaintiffs complaints. In 2001, our motion to dismiss was granted in a similar case on this basis. We intend to defend these lawsuits vigorously but are unable currently to predict the outcome or to reasonably estimate the range of potential loss, if any.

Hormone Replacement Therapy

We have been named as a defendant in seventeen lawsuits involving the manufacture and sale of hormone replacement therapy drugs. Numerous pharmaceutical companies have also been sued. These cases have been filed in Alabama, Arkansas, Missouri, Pennsylvania, Ohio, Minnesota, Florida, Maryland and Mississippi. The plaintiffs allege that we and other defendants failed to conduct adequate pre-approval research and post-approval surveillance to establish the safety of the long-term hormone therapy regimen, thus misleading consumers when marketing their products. Plaintiffs claims include allegations of negligence, strict liability, breach of implied warranty, breach of express warranty, fraud and misrepresentation. We intend to defend these lawsuits vigorously but are unable currently to predict the outcome or to reasonably estimate the range of potential loss, if any.

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Average Wholesale Pricing Litigation

In August 2004, we and Monarch Pharmaceuticals, Inc. (Monarch), a wholly owned subsidiary of ours, 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 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.

In August 2004, a defendant in the NYC action sought to have the action transferred to the United States District Court for the District of Massachusetts and combined with existing multi-district litigation, entitled In re Pharmaceutical Industry Average Wholesale Pricing Litigation, being heard by that court. A conditional transfer order was issued during September 2004 indicating that the action is subject to transfer for pretrial proceedings to the United States District Court for the District of Massachusetts. We intend to defend this lawsuit vigorously but are unable currently to predict the outcome or reasonably estimate the range of loss, if any.

We also have been named as a defendant along with other pharmaceutical manufacturers in thirty-four other lawsuits containing allegations of fraudulently inflating average wholesale prices. These lawsuits have been filed in federal courts in New York and Massachusetts, and in state courts in New York, Mississippi, and Alabama, some of which we are seeking to have transferred to the United States District Court for the District of Massachusetts and combined with the existing multi-district litigation.

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. The actions generally have been brought by individuals in their own right and have been filed in various state and federal jurisdictions throughout the United States. They seek, among other things, compensatory and punitive damages and/or court-supervised medical monitoring of persons who have ingested the product. We are one of many defendants in no more than six lawsuits that claim damages for personal injury arising from our production of the anorexigenic drug phentermine under contract for GlaxoSmithKline.

While we cannot predict the outcome of these suits, we believe that the claims against us are without merit and we intend to vigorously pursue all defenses available to us. We are being indemnified in all of these suits by GlaxoSmithKline, for which we manufactured the anorexigenic product, provided that neither the lawsuits nor the associated liabilities are based upon our independent negligence or intentional acts. We intend to submit a claim for all unreimbursed costs to our product liability insurance carrier. However, in the event that GlaxoSmithKline is unable to satisfy or fulfill its obligations under the indemnity, we would have to defend the lawsuits and be responsible for damages, if any, that are awarded against it or for amounts in excess of our product liability coverage. A reasonable estimate of possible losses related to these suits cannot be made.

In addition, King Research and Development is a defendant in approximately 143 multi-defendant lawsuits involving the manufacture and sale of dexfenfluramine, fenfluramine and phentermine. These suits have been filed in various jurisdictions throughout the United States and in each of these suits King Research and Development, as the successor to Jones, is one of many defendants, including manufacturers and other distributors of these drugs. Although Jones did not at any time manufacture dexfenfluramine, fenfluramine, or phentermine, Jones was a distributor of a generic phentermine product and, after its acquisition of Abana Pharmaceuticals, was a distributor of Obenix®, Abana s branded phentermine product. The plaintiffs in these cases claim injury as a result of ingesting a combination of these weight-

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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 and misrepresentation.

King Research and Development denies any liability incident to the distribution of Obenix® or Jones generic phentermine product and intends to pursue all defenses available to it. King Research and Development s insurance carriers are currently defending King Research and Development in these suits. The manufacturers of fenfluramine and dexfenfluramine have settled many of these cases. In the event that King Research and Development s insurance coverage is inadequate to satisfy any resulting liability, King Research and Development will have to resume defense of these lawsuits and be responsible for the damages, if any, that are awarded against it.

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

Other Legal Proceedings

The Rochester facility was one of six facilities owned by Pfizer subject to a Consent Decree of Permanent Injunction issued August 1993 in United States of America v. Warner-Lambert Company and Melvin R. Goodes and Lodewijk J.R. DeVink (U.S. Dist. Ct., Dist. of N.J.) (the Consent Decree). We acquired the Rochester facility in February 1998. In July 2005, the Court lifted the Consent Decree and the Rochester facility is no longer subject to the Consent Decree.

We are also involved in various routine legal proceedings incident to the ordinary course of our business.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

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PART II

Item 5. ***Market for Common Equity and Related Stockholder Matters***

The following table sets forth the range of high and low sales prices per share of our common stock for the periods indicated. Our common stock is listed on the New York Stock Exchange, where it trades under the symbol KG. There were approximately 1,050 shareholders on February 27, 2006, based on the number of record holders of the common stock.

	2005	
	High	**Low**
First quarter	$ 12.58	$ 8.28
Second quarter	10.60	7.50
Third quarter	16.39	10.11
Fourth quarter	17.45	14.22

	2004	
	High	**Low**
First quarter	$ 20.62	$ 15.24
Second quarter	18.68	11.30
Third quarter	14.00	10.32
Fourth quarter	12.87	10.01

On February 27, 2006, the closing price of our common stock as reported on the New York Stock Exchange was $19.87.

We have never paid cash dividends on our common stock. The payment of cash dividends is subject to the discretion of the board of directors and will be dependent upon many factors, including our earnings, our capital needs, and our general financial condition. We currently anticipate that for the foreseeable future, we will retain our earnings.

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Item 6. ***Selected Financial Data***

The table below should be read in conjunction with the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements and related notes included elsewhere in this report.

	For the Year Ended December 31,				
	2005	2004	2003	2002	2001
	(in thousands, except per share data)				
Statement of Income Data:					
Net sales	$ 1,694,753	$ 1,225,890	$ 1,424,424	$ 1,029,649	$ 802,380
Royalty revenue	78,128	78,474	68,365	58,375	46,774
Total revenues	1,772,881	1,304,364	1,492,789	1,088,024	849,154
Operating income (loss)(3)	180,079	(41,264)	151,952	275,043	351,379
Interest income	18,175	5,974	6,849	22,395	10,975
Interest expense	(11,931)	(12,588)	(13,396)	(12,419)	(12,684)
Valuation (charge) benefit convertible notes receivable		(2,887)	18,551	(35,629)	
Loss on investment	(6,182)	(6,520)			
Extinguishment of debt expense(2)					(22,903)
Other (expense) income, net	(2,026)	(749)	(629)	(884)	6,313
Income (loss) from continuing operations before income taxes, discontinued operations and cumulative effect of change in accounting principle	178,115	(58,034)	163,327	248,506	333,080
Income tax expense (benefit)	61,485	(7,412)	65,884	78,033	123,829
Income (loss) from continuing operations	116,630	(50,622)	97,443	170,473	209,251
Income (loss) from discontinued operations(4)	1,203	(109,666)	(5,489)	11,928	9,230
Income (loss) before cumulative effect of change in accounting principle	117,833	(160,288)	91,954	182,401	218,481
Cumulative effect of change in accounting principle(1)					(545)
Net income (loss)	$ 117,833	$ (160,288)	$ 91,954	$ 182,401	$ 217,936
Income per common share:					
Basic:					

Income (loss) from continuing operations before cumulative effect of change in accounting principle	$ 0.48	$ (0.21)	$ 0.40	$ 0.70	$ 0.90
Income (loss) from discontinued operations	0.01	(0.45)	(0.02)	0.05	0.04
Cumulative effect of change in accounting principle					
	$ 0.49	$ (0.66)	$ 0.38	$ 0.75	$ 0.94
Diluted:					
Income (loss) from continuing operations before cumulative effect of change in accounting principle	$ 0.48	$ (0.21)	$ 0.40	$ 0.69	$ 0.89
Income (loss) from discontinued operations	0.01	(0.45)	(0.02)	0.05	0.04
Cumulative effect of change in accounting principle					
	$ 0.49	$ (0.66)	$ 0.38	$ 0.74	$ 0.93

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	December 31,	
	2005	2004
	(in thousands)	
Balance Sheet Data:		
Working capital	$ 276,329	$ 438,133
Total assets	2,965,242	2,924,156
Total debt	345,000	345,000
Shareholders equity	1,973,422	1,848,790

(1) Reflects the cumulative effect of a change in accounting principle of $545 (net of taxes of $325) due to the adoption of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, during the first quarter of 2001.

(2) Reflects early extinguishment of debt expense in connection with the repayment of some of our debt instruments during 2001.

(3) Results for 2003 reflect a $15,212 reduction in the co-promotion fees paid to our Altace® co-promotion partner as a result of charges for amounts due under Medicaid and other governmental pricing programs for the years 1998 to 2002. Specifically (a) we recovered on a pre-tax basis $9,514 in fees we previously accrued during the fourth quarter of 2002 and have reduced the accrual for these fees by this amount in the fourth quarter of 2003 and (b) fees under our Co-Promotion Agreement for Altace® in the fourth quarter of 2003 were reduced on a pre-tax basis by an additional $5,698 as a result of the Medicaid accrual adjustment recorded in that quarter.

(4) Reflects the classification of Nordette® and Prefest® product lines as discontinued operations. See Note 27 to our audited consolidated financial statements included elsewhere in this report.

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with the other parts of this report, including the audited consolidated financial statements and related notes. Historical results and percentage relationships set forth in the statement of income, including trends that might appear, are not necessarily indicative of future operations. Please see the Risk Factors and Forward-Looking Statements sections for a discussion of the uncertainties, risks and assumptions associated with these statements.

OVERVIEW

Our Business

We are a vertically integrated pharmaceutical company that develops, manufactures, markets and sells branded prescription pharmaceutical products. We seek to capitalize on opportunities in the pharmaceutical industry through the development, including through in-licensing arrangements and acquisitions, of novel branded prescription pharmaceutical products in attractive markets and the strategic acquisition of branded products that can benefit from focused promotion and marketing and product life-cycle management.

Under our corporate strategy we work to achieve organic growth by maximizing the potential of our currently marketed products and prudent product life-cycle management. We also work to achieve organic growth by continuing to develop investigational drugs that are in our pipeline.

Our strategy also focuses on growth through the acquisition of novel branded pharmaceutical products in later stages of development and technologies that have significant market potential that complement our three key therapeutic areas of focus. Utilizing our internal resources and a disciplined business development process, we strive

to be a leader and partner of choice in bringing innovative, clinically-differentiated therapies and technologies to market in our key therapeutic areas. We may also seek company acquisitions which add products or products in development, technologies or sales and marketing capabilities to our key therapeutic areas or that otherwise complement our operations.

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Our business consists of five segments which include branded pharmaceuticals, Meridian Medical Technologies, royalties, contract manufacturing, and other. In accordance with our strategy, our branded pharmaceutical products can be divided into the following therapeutic areas:

Cardiovascular/metabolic (including Altace® and Levoxyl®),

Neuroscience (including Sonata® and Skelaxin®),

Hospital/acute care (including Thrombin-JMI®), and

Other.

We believe each of our key therapeutic areas of focus has significant market potential and our organization is aligned accordingly.

Our Meridian Medical Technologies segment consists of our auto-injector business, which includes EpiPen® and nerve gas antidotes which we provide to the U.S. Military. Royalties relates to revenues we derive from successfully developed products that we have licensed to third parties. Our contract manufacturing segment manufactures pharmaceutical products for third parties under contracts with a number of pharmaceutical and biotechnology companies.

2005 Highlights

Introduction

During 2005, we achieved many important accomplishments that we believe will better position us for long-term growth. Among our many accomplishments, we:

believe we normalized the level of wholesale inventories of our branded pharmaceutical products;

entered into definitive settlement agreements to resolve the governmental inquiries related to our underpayments of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002;

enhanced the strength of our executive management team; and

strengthened our research and development pipeline with the addition of Remoxy™ and up to three additional opioid products, and the continued development of PT-141 and other investigational drugs in our pipeline.

We believe these accomplishments position us to continue executing our strategy for long-term growth in 2006.

Wholesale Inventory Reductions

During late 2003, we became aware of the need to improve our visibility with respect to wholesale inventory levels of our branded pharmaceutical products. As a result, in April 2004 we successfully entered into inventory management agreements (IMAs) with each of our three key wholesale customers covering all of our branded products for the purpose of obtaining data regarding and reducing the level of wholesale inventories of our products. As we anticipated, entering into the IMAs adversely affected net sales of some of our branded pharmaceutical products, particularly during 2004, as wholesale inventory levels of these products were aggressively reduced.

During the fourth quarter of 2004, we amended our IMAs with our key wholesale customers with the objective of further reducing their inventory of our products. As a result, the average wholesale inventory level of our key products was further reduced during the fourth quarter of 2004 and the first quarter of 2005. This process was substantially complete for our key products by the end of the first quarter of 2005.

Wholesale inventory data provided by our customers indicates that wholesale inventory levels of our key branded products, Altace®, Skelaxin®, Thrombin-JMI®, Sonata® and Levoxyl®, were each at one month or less of estimated end-user demand as of December 31, 2005. The data on which we based our original third quarter estimate of wholesale inventory levels was incorrect primarily due to reporting errors by some of our customers. Accordingly, we now believe that the wholesale inventory levels of Altace® and

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Skelaxin®, as of the end of the third quarter of 2005, were slightly higher than one month of end-user demand. We estimate that the wholesale and retail inventories of our products as of December 31, 2005 represents gross sales of approximately $190.0 million to $210.0 million.

Settlement of Governmental Pricing Investigation

On October 31, 2005, we entered into definitive settlement agreements with the United States of America and with 48 states and the District of Columbia to resolve the governmental investigations related to the underpayment of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002. We have agreed to a settlement with the remaining state on substantially the same terms as the other state settlements, and we expect to enter into a definitive settlement agreement with that state before the end of the first quarter of 2006. On March 2, 2006, we paid approximately $126.9 million, comprising the settlement amount and accrued interest under our settlement agreements with the United States and the 48 states and the District of Columbia. We have further agreed to pay approximately $0.4 million to the remaining state and, subject to certain conditions, certain legal fees and settlement costs in the amount of approximately $1.8 million. We currently expect to pay these additional amounts by the end of the first quarter of 2006. In addition, we have entered into a five-year corporate integrity agreement with the Office of Inspector General of the Department of Health and Human Services pursuant to which we are required, among other things, to keep in place our current compliance program, to provide periodic reports and to submit to audits relating to our Medicaid rebate calculations.

Consummation of the federal settlement agreement and some state settlement agreements is or was subject to court approval. On February 24, 2006, the United States District Court for the Eastern District of Pennsylvania (District Court) approved the federal settlement agreement. All interested parties, including us, the individual purportedly acting as a relator under the False Claims Act and the affected states, have requested that the District Court approve the state settlement agreements that require court approval.

The previously disclosed claim seeking damages from us because of alleged retaliatory actions against the relator was dismissed with prejudice on January 31, 2006.

The settlement agreements described above will not resolve any of the previously disclosed civil suits that are pending against us and related individuals and entities discussed under the heading Securities and ERISA Litigation in the section below entitled Liquidity and Capital Resources. Also, the SEC investigation of our previously disclosed errors relating to reserves for product returns is continuing. For additional information and a discussion regarding the governmental investigations, please see Settlement of Governmental Pricing Investigation and SEC Investigation in the section below entitled Liquidity and Capital Resources.

Executive Management Team Additions

We continued to enhance our executive management team in 2005 with several notable additions, including Joseph Squicciarino, our new Chief Financial Officer, who has over twenty years of financial experience in the pharmaceutical industry. Another important addition is Eric J. Bruce, our new Chief Technical Operations Officer, who assumes responsibility for our manufacturing, logistics, distribution and quality organizations. Mr. Bruce has over 25 years of manufacturing experience.

Remoxy™/ R&D Pipeline

On November 10, 2005, we entered into a strategic alliance with Pain Therapeutics, Inc. to develop and commercialize Remoxy™ and potentially up to three other abuse-resistant opioid painkillers. Remoxy™ is an investigational drug in late-stage clinical development by Pain Therapeutics for the treatment of moderate-to-severe-chronic pain and represents the first of what is expected to be an entirely new class of proprietary drugs, abuse-resistant opioid painkillers.

Under the terms of the agreement, we made an up-front payment of $150.0 million in cash during the fourth quarter of 2005. Pain Therapeutics could also receive additional milestone payments of up to

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$150.0 million in cash based on the successful clinical and regulatory development of Remoxy™ and other abuse-resistant opioid products. This amount includes a $15.0 million cash payment upon acceptance of a regulatory filing for Remoxy™ and an additional $15.0 million upon its approval. We are responsible for all research and development expenses related to this alliance, which could total $100.0 million. We are also responsible for the payment of third-party royalty obligations of Pain Therapeutics related to products developed under this collaboration.

Remoxy™, which is currently in Phase III clinical trials, is being developed as an abuse-resistant version of long-acting oxycodone, which is also known as Oxycontin®. The Remoxy™ formulation consists of a sticky, high-viscosity mass that is not prone to injection or snorting. It is intended to meet the needs of physicians who appropriately prescribe opioid painkillers and who seek to minimize risks of drug diversion, abuse or accidental patient misuse. Published data show that freezing, crushing, or submerging Remoxy™ in high-proof alcohol for hours at a time releases just a fraction of oxycodone compared to currently available formulations of oxycodone at time points when abusers presumably expect to be able to abuse its active ingredient.

With the addition of Remoxy™, our current research and development pipeline includes three products in Phase III and two products in late Phase II. In addition to Remoxy™, our Phase III products include binodenoson, a pharmacologic cardiac stress imaging agent intended to provide a reduced side effects profile compared to the currently approved product Adenoscan®. Also in Phase III is Vanquix™, our diazepam-filled auto-injector that is currently under development as the only therapy of its kind for the treatment of acute, repetitive epileptic seizures.

Our Phase II compounds are led by PT-141, under our collaborative agreement with Palatin Technologies. PT-141 is the first compound in a new drug class called melanocortin receptor agonists under development to treat sexual dysfunction in both men and women. Data obtained in trials, completed to date, indicates that PT-141 is effective in male erectile dysfunction (ED) and provides additive benefit to PDE-5 inhibitors. This new chemical entity is being evaluated in Phase II clinical trials studying the efficacy and safety profile of varying doses of this novel compound in men experiencing ED and women experiencing female sexual dysfunction.

Also in Phase II is MRE-0094, an adenosine A2a receptor agonist for the topical treatment of chronic, neuropathic, diabetic foot ulcers. In the second half of 2006, we also expect to begin the Phase II program for T-62, an adenosine A1 allosteric enhancer that we are developing for the treatment of neuropathic pain.

On December 6, 2005, we entered into a cross-license agreement with Mutual Pharmaceutical Company, Inc. Under the terms of the agreement, each of the parties granted the other a worldwide license to certain intellectual property, including patent rights and know-how, relating to metaxalone. The intellectual property licensed to us relates to the potential for improved dosing and administration of metaxalone. Pursuant to the agreement, we paid Mutual an upfront payment of $35.0 million and will pay Mutual royalties on net sales of products containing metaxalone beginning on January 1, 2006. Our current formulation of metaxalone is Skelaxin®. The royalty rate may increase depending on the achievement of certain regulatory and commercial milestones of metaxalone products.

On September 8, 2005, we entered into a strategic collaboration with Inyx, Inc. relating to Intal® and Tilade®, which includes the continued development of a new formulation of Intal® utilizing hydrofluoroalkane (HFA), an environmentally friendly propellant. These products are our currently marketed inhaled anti-inflammatory agents for the management of asthma. Pursuant to the agreements, we and Inyx will co-market Intal® and Tilade® and each have a share of net revenues. We will continue to market to hospitals and primary-care physicians, while Inyx will pursue direct sales to the specialist markets. Inyx also plans to supervise the distribution of Intal® HFA in Canada.

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OPERATING RESULTS

The following table summarizes total revenues and cost of revenues by operating segment:

	For the Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
Total Revenues			
Branded pharmaceuticals	$ 1,542,124	$ 1,076,517	$ 1,272,350
Meridian Medical Technologies	129,261	123,329	124,157
Royalties	78,128	78,474	68,365
Contract manufacturing	22,167	26,045	27,289
Other	1,201	(1)	628
Total revenues	$ 1,772,881	$ 1,304,364	$ 1,492,789
Cost of Revenues			
Branded pharmaceuticals	$ 222,924	$ 251,568	$ 280,580
Meridian Medical Technologies	62,958	59,296	66,203
Royalties	9,003	10,878	11,243
Contract manufacturing	27,055	31,207	27,204
Other cost of revenues	1,045	(11)	611
Total cost of revenues	$ 322,985	$ 352,938	$ 385,841
Gross Profit			
Branded pharmaceuticals	$ 1,319,200	$ 824,949	$ 991,770
Meridian Medical Technologies	66,303	64,033	57,954
Royalties	69,125	67,596	57,122
Contract manufacturing	(4,888)	(5,162)	85
Other	156	10	17
Total gross profit	$ 1,449,896	$ 951,426	$ 1,106,948

The following table summarizes our gross to net sales deductions:

	For the Years Ended December 31,		
	2005	2004	2003
	(in thousands)		
Gross Sales	$ 2,240,852	$ 2,017,296	$ 2,015,710
Returns	5,012	183,066	103,525
Chargebacks	99,057	114,995	106,964
Commercial Rebates	192,203	203,405	172,720
Medicaid Rebates	78,753	135,545	106,614
Trade Discounts/Other	91,090	62,739	19,986

	$ 1,774,737	$ 1,317,546	$ 1,505,901
Discontinued Operations	1,856	13,182	13,112
Net Sales	$ 1,772,881	$ 1,304,364	$ 1,492,789

Gross sales were higher in 2005 compared to 2004 primarily due to the effect of higher unit sales as a result of the effect of a higher level of wholesale inventory reduction of some of our branded pharmaceutical products during 2004, and price increases, particularly with respect to Thrombin-JMI®. Please see the information under the heading Wholesale Inventory Reductions above.

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Returns expense was lower in 2005 than in 2004 primarily due to the decrease in actual returns primarily resulting from the effects of a higher level of wholesale inventory reduction of some of our branded pharmaceutical products in 2004, and the effect of a reduction in reserves for returns. For additional information on the change in estimate, please see below.

Medicaid rebate expense was lower in 2005 than in 2004 primarily due to changes in estimates and changes in reserves related to wholesale inventory levels. For additional information on the change in estimate, please see below.

Gross sales remained fairly consistent in 2004 compared to 2003 despite price increases and a full year of sales of Skelaxin® and Sonata®, products purchased in June of 2003, primarily due to lower unit sales as a result of the effect of a higher level of wholesale inventory reduction of some of our branded pharmaceutical products during 2004. Please see the information under the heading Wholesale Inventory Reductions above.

Returns expense was higher in 2004 than in 2003 primarily due to an increase in actual returns as a result of the effects of a higher level of wholesale inventory reduction in 2004 and the entry of generic competition for Levoxyl®.

Commercial rebate expense was higher in 2004 than in 2003 primarily due to increased utilization of Altace® under managed care contracts and a full year of commercial rebates on Skelaxin® and Sonata®, products acquired in June 2003.

The following tables provide the activity and ending balances for our significant gross to net categories:

Accrual for Rebates (in thousands):

	2005	2004
Balance at January 1, net of prepaid amounts	$ 172,161	$ 213,893
Current provision related to sales made in current period	270,605	291,365
Current provision related to sales made in prior periods	(24,008)	20,305
Actual rebates	(298,844)	(353,402)
Ending balance, net of prepaid amounts	$ 119,914	$ 172,161

Accrual for Returns (in thousands):

	2005	2004
Balance at January 1	$ 122,863	$ 82,477
Current provision	5,012	183,066
Actual returns	(76,973)	(142,680)
Ending balance	$ 50,902	$ 122,863

Accrual for Chargebacks (in thousands):

	2005	2004
Balance at January 1	$ 27,953	$ 25,349
Current provision	99,057	114,995
Actual chargebacks	(113,857)	(112,391)
Ending balance	$ 13,153	$ 27,953

Based on data received from our inventory management agreements with our three key wholesale customers, during the first quarter of 2005 there was a significant reduction of wholesale inventory levels of

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our products. While our calculation for returns reserves is based on historical sales and return rates over the period which customers have a right of return, we also consider the amount of wholesale inventory levels. The significant reduction in wholesale inventories of our products during the first quarter of 2005 resulted in a decrease of approximately $20.0 million in our reserve for returns and a corresponding increase in net sales from branded pharmaceuticals, excluding the adjustment to sales classified as discontinued operations. In the second quarter of 2005, an additional reduction in wholesale inventories resulted in a decrease of approximately $5.0 million in our reserve for returns and a corresponding increase in net sales from branded pharmaceuticals, excluding the adjustment to sales classified as discontinued operations. The 2005 current provision amounts in the table Accrual for Returns, above, have therefore been reduced by these amounts.

During the third quarter of 2005, our actual returns of branded pharmaceutical products continued to decrease significantly on a quarterly basis compared to actual returns during the quarterly periods in 2004 and the first quarter of 2005. Additionally, based on data received pursuant to our inventory management agreements with our key wholesale customers, we continued to experience normalized wholesale inventory levels of our branded pharmaceutical products during the third quarter of 2005. Accordingly, we believe that the rate of returns experienced during the second and third quarters of 2005 is more indicative of what we should expect in future quarters and have adjusted our returns reserve accordingly. This change in estimate resulted in a decrease of approximately $15.0 million in the returns reserve in the third quarter and a corresponding increase in net sales from branded pharmaceutical products, excluding the adjustment to sales classified as discontinued operations. The 2005 current provision amount in the Accrual for Returns above, has therefore been reduced by this amount. As a result of this increase in net sales, the co-promotion expense related to net sales of Altace® in the third quarter of 2005 increased by approximately $5.0 million. The effect of the change in estimate on third quarter 2005 operating income was, therefore, approximately $10.0 million.

As a result of our previously disclosed determination that we underpaid amounts due to Medicaid and other government pricing programs from 1998 through 2002, we developed a refined calculation to compute the Average Manufacturer s Price (AMP) and Best Price in compliance with federal laws and regulations. For a discussion regarding the underpayment to Medicaid and other government pricing programs from 1998 through 2002, please see Settlement of Governmental Pricing Investigation in Item 3, Legal Proceedings. During the third quarter of 2005, we began reporting to the Centers for Medicare and Medicaid Services using our refined calculation for computing AMP and Best Price. In addition, during the third quarter of 2005, we recalculated rebates due with respect to prior quarters utilizing the refined AMP and Best Price calculations. As a result of this updated information, during the third quarter of 2005, we decreased our reserve for estimated Medicaid and other government pricing program obligations and increased net sales from branded pharmaceutical products by approximately $21.0 million, approximately $8.0 million of which related to years prior to 2005. This does not include the adjustment to sales classified as discontinued operations. As a result of the increase in net sales, the co-promotion expense related to net sales of Altace® increased by approximately $6.0 million, approximately $4.0 million of which related to years prior to 2005. The effect of the change in estimate on operating income was, therefore, approximately $15.0 million, approximately $4.0 million of which related to years prior to 2005.

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Branded Pharmaceuticals

	For the Years Ended December 31,			Change 2005 vs. 2004		Change 2004 vs. 2003	
	2005	2004	2003	$	%	$	%
	(in thousands)						
Branded pharmaceutical revenue:							
Altace®	$ 554,353	$ 347,292	$ 536,932	$ 207,061	59.6%	$ (189,640)	(35.3)%
Skelaxin®	344,605	238,563	175,235	106,042	44.5	63,328	36.1
Thrombin-JMI®	220,617	174,570	140,403	46,047	26.4	34,167	24.3
Levoxyl®	139,513	104,749	125,084	34,764	33.2	(20,335)	(16.3)
Sonata®	83,162	60,365	71,579	22,797	37.8	(11,214)	(15.7)
Other	199,874	150,978	223,117	48,896	32.4	(72,139)	(32.3)
Total revenue	$ 1,542,124	$ 1,076,517	$ 1,272,350	$ 465,607	43.3%	$ (195,833)	(15.4)%
Cost of Revenues	222,924	251,568	280,580	(28,644)	(11.4)	(29,012)	(10.3)
Gross Profit Margin	$ 1,319,200	$ 824,949	$ 991,770	$ 494,251	59.9%	$ (166,821)	(16.8)%

Net sales from branded pharmaceutical products were higher in 2005 than in 2004 primarily due to the effect of higher unit sales and a lower rate of reserve for returns of some of these products in 2005 as a result of the effect of a higher level of wholesale inventory reductions of some of our branded pharmaceutical products during 2004, the effect of a reduction in reserves for returns and rebates and price increases, particularly with respect to Thrombin-JMI®. For discussions regarding the effects of wholesale inventory reductions, please see the information under the heading Wholesale Inventory Reductions above. Based on inventory data provided to us by our key customers, we believe that wholesale inventory levels of our key products, Altace®, Skelaxin®, Thrombin-JMI®, Levoxyl®, and Sonata®, as of December 31, 2005, are at normalized levels of less than one month of end-user demand for these products. We do not believe net sales of branded pharmaceutical products will continue to grow at the rate experienced in 2005, due to the factors effecting sales growth described above. For a discussion regarding the potential risk of generic competition for Altace®, Skelaxin®, and Sonata®, please see Altace® Patent Challenge, Skelaxin® Patent Challenge, and Sonata® Patent Challenge, in Item 3, Legal Proceedings.

Sales of Key Products

Altace®

Net sales of Altace® were higher in 2005 than in 2004 primarily due to higher unit sales and a lower rate of reserve for returns of the product in 2005 as a result of the effects of a higher level of wholesale inventory reductions of Altace® in 2004, a reduction in the reserves for returns and rebates of Altace® in 2005, and price increases. We do not believe Altace® net sales will continue to grow at the rate experienced in 2005, due to the factors effecting sales growth described above. Total prescriptions for Altace® increased approximately 1% in 2005 from 2004 according to IMS America, Ltd. (IMS) monthly prescription data. During the last half of 2005, prescriptions for Altace® were flat to declining. We anticipate this trend to continue in 2006. For a discussion regarding the risk of potential generic competition for Altace®, please see Altace® Patent Challenge, in Item 3, Legal Proceedings.

Net sales of Altace® were lower in 2004 than in 2003 primarily due to lower unit sales and a higher rate of reserves for returns of the product as a result of the effects of a higher level of wholesale inventory reductions in 2004. Total prescriptions for Altace® increased approximately 9% in 2004 from 2003 according to IMS monthly prescription data.

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For discussions regarding the effects of wholesale inventory reductions, please see the information under the heading Wholesale Inventory Reductions above.

Thrombin-JMI®

Net sales of Thrombin-JMI® increased in 2005 compared to 2004 due to the effect of price increases and increased unit sales. The increase in net sales of Thrombin-JMI® in 2004 from 2003 was due to price increases as total unit sales of Thrombin-JMI® sold decreased. The rate at which net sales of Thrombin-JMI® increased in 2005 may not continue in 2006 as it will not benefit from price increases at the rate experienced in 2005.

Skelaxin®

Net sales of Skelaxin® increased in 2005 from 2004 primarily due to higher unit sales as a result of the effects of a higher level of wholesale inventory reductions of Skelaxin® in 2004. Net sales of Skelaxin® in 2005 also benefited from a reduction in reserves for returns and rebates of Skelaxin® and modest price increases. We do not believe Skelaxin® net sales will continue to grow at the rate experienced in 2005, due to the factors effecting net sales growth described above. For discussions regarding the effects of wholesale inventory reductions, please see under the headings Wholesale Inventory Reductions above. Total prescriptions for Skelaxin declined approximately 10% in 2005 from 2004 according to IMS monthly prescription data. The declining prescriptions trend may not continue in 2006 due to reinvigorated promotion of the product.

Net sales of Skelaxin® were higher in 2004 compared to 2003 primarily because we did not acquire the product until June 2003. Total prescriptions for Skelaxin declined approximately 10% in 2004 from 2003 according to IMS monthly prescription data.

As previously disclosed, the Skelaxin® patents are the subject of multiple challenges. Under the current circumstances, the continued exclusivity of Skelaxin® is unpredictable and we cannot assure that the product will remain exclusive for any length of time. For a discussion regarding the risk of potential generic competition for Skelaxin®, please see under the heading Skelaxin® Patent Challenge in Item 3, Legal Proceedings.

Sonata®

Net sales of Sonata® were higher in 2005 than in 2004 primarily due to higher unit sales as a result of the effects of a higher level of wholesale inventory reductions of Sonata® in 2004. Net sales of Sonata® in 2005 also benefited from modest price increases. For discussions regarding the effects of wholesale inventory reductions, please see under the headings Wholesale Inventory Reductions above. Total prescriptions for Sonata® decreased approximately 12% in 2005 from 2004 according to IMS monthly prescription data. The decrease in prescriptions during 2005 was primarily due to increased competition during 2005. We believe net sales of the product in 2006 will decrease as other potential competitive insomnia products may enter the market during 2006. For a discussion regarding the risk of potential generic competition for Sonata®, please see Sonata® Patent Challenge in Item 3, Legal Proceedings.

Net sales of Sonata® were lower in 2004 than in 2003 primarily due to lower unit sales as a result of the effects of a higher level of wholesale inventory reductions of Sonata® in 2004. We acquired Sonata® in June of 2003. Total prescriptions for Sonata® decreased approximately 7% in 2004 from 2003 according to IMS monthly prescription data.

Levoxyl®

In 2004, the FDA approved certain other levothyroxine sodium products as bioequivalent and therapeutically equivalent to Levoxyl®. Since this time, Levoxyl® has competed in a highly genericized market.

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Net sales of Levoxyl® were higher in 2005 than in 2004, notwithstanding lower unit sales due to generic competition, primarily due to a lower rate of actual returns of the products and a reduction in the amount of commercial rebates. Total prescriptions for Levoxyl® decreased approximately 33% in 2005 from 2004 according to IMS monthly prescription data. Due to the continued erosion in total prescriptions for Levoxyl® as a result of the entry of generic competition for the product in 2004, we believe that net sales of this product in 2006 should decrease significantly compared to 2005.

Net sales of Levoxyl® were lower in 2004 than in 2003 primarily due to lower unit sales and a higher rate of actual returns primarily due to the generic competition which entered the market in 2004. Total prescriptions for Levoxyl® decreased approximately 11% in 2004 from 2003 according to IMS monthly prescription data.

Other

Net sales of other branded pharmaceutical products were higher in 2005 than in 2004 primarily due to the effects of a higher level of wholesale inventory reductions of other branded pharmaceutical products in 2004. Net sales of other branded pharmaceutical products in 2005 benefited from a reduction in reserves for returns and rebates for these products and modest price increases. Most of these products are not promoted through our sales force and prescriptions on many of these products are declining. We do not believe net sales of other branded pharmaceutical products will continue to grow at the rate experienced in 2005, due to the factors effecting sales growth described above.

Net sales of other branded pharmaceutical products were lower in 2004 than in 2003 primarily due to the effects of a higher level of wholesale inventory reductions of other branded pharmaceutical products in 2004.

For discussions regarding the effects of wholesale inventory reductions, please see the information under the heading Wholesale Inventory Reductions above.

Cost of Revenues

Cost of revenues from branded pharmaceutical products was lower in 2005 compared to 2004 primarily due to the following:

- a charge during 2004 of approximately $46.0 million for the write-off of excess inventory which was partially attributable to reduced unit sales of products during 2004 as a result of wholesale inventory reductions;

- differences in special items which benefited 2005 compared to 2004 as discussed below.

These two items were partially offset by the cost of revenues associated with higher unit sales of branded prescription products in 2005.

Cost of revenues from branded pharmaceutical products was lower in 2004 compared to 2003 primarily due to a reduction in the amount of special items affecting cost of revenues and lower unit sales of our branded pharmaceutical products as a result of the wholesale inventory reductions discussed above. For additional information and a description of the effect of wholesale channel inventory on net sales, please see the section above entitled Wholesale Inventory Reductions.

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

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However, it should be noted that the determination of whether to classify an item as a special charge involves judgments by us.

Special items affecting cost of revenues from branded pharmaceuticals during 2005, 2004 and 2003 included the following:

As a result of declining Lorabid® prescriptions in 2003, we determined that we would not sell all of the Lorabid® inventory that we were required to purchase under our supply agreement with Eli Lilly. Accordingly, we recorded a $34.0 million charge during 2003 primarily related to our purchase commitments for Lorabid® that were in excess of expected demand. We recorded a similar charge in 2004 in the amount of $8.9 million for our purchase commitments for Lorabid® and some other small products for which commitments exceeded expected demand. With the termination of some of these purchase commitment contracts in 2005, we had a benefit of approximately $6.1 million which reduced our cost of revenues from branded pharmaceutical product.

We incurred charges in the amount of $4.6 million in 2004 and $4.3 million in 2003 primarily related to the voluntary recalls of certain lots of Levoxyl®. Product returned as a result of this voluntary recall was less than originally estimated. Accordingly, cost of revenues from branded pharmaceutical products in 2005 was reduced by approximately $2.5 million.

We anticipate cost of revenues will increase in 2006 compared to 2005 due to additional royalties we will pay on Skelaxin® beginning on January 1, 2006.

Meridian Medical Technologies

				Change			
	For the Years Ended December 31,			2005-2004		2004-2003	
	2005	2004	2003	$	%	$	%
	(in thousands)						
Meridian Medical Technologies revenue	$ 129,261	$ 123,329	$ 124,157	$ 5,932	4.8%	$ (828)	(0.7)%
Cost of Revenues	62,958	59,296	66,203	3,662	6.2	(6,907)	(10.4)
Gross Profit Margin	$ 66,303	$ 64,033	$ 57,954	$ 2,270	3.5%	$ 6,079	10.5%

Cost of revenues from Meridian Medical Technologies in 2003 includes a special item that resulted in a charge of $2.1 million relating to the step-up in the cost of Meridian s inventory at the time of our acquisition.

Royalties

				Change			
	For the Years Ended December 31,			2005-2004		2004-2003	
	2005	2004	2003	$	%	$	%
	(in thousands)						
Royalty revenue	$ 78,128	$ 78,474	$ 68,365	$ (346)	(0.4)%	$ 10,109	14.8%
Cost of Revenues	9,003	10,878	11,243	(1,875)	(17.2)	(365)	(3.2)

Gross Profit Margin	$ 69,125	$ 67,596	$ 57,122	$ 1,529	2.3%	$ 10,474	18.3%

Revenues from royalties are derived primarily from payments we receive based on sales of Adenoscan®. We are not responsible for the marketing of these products and, thus, are not able to predict whether revenue from royalties will increase or decrease in 2006. For a discussion regarding the potential risk of generic competition for Adenoscan®, please see Adenoscan® Patent Challenge in Item 3, Legal Proceedings.

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Contract Manufacturing

	For the Years Ended December 31,			Change 2005-2004		Change 2004-2003	
	2005	2004	2003	$	%	$	%
	(in thousands)						
Contract manufacturing revenue	$ 22,167	$ 26,045	$ 27,289	$ (3,878)	(14.9)%	$ (1,244)	(4.6)%
Cost of Revenues	27,055	31,207	27,204	(4,152)	(13.3)	4,003	14.7
Gross Profit Margin	$ (4,888)	$ (5,162)	$ 85	$ 274	5.3%	$ (5,247)	

Revenues from contract manufacturing decreased in 2005 due to a lower volume of units manufactured for third parties. This decline may continue in future periods.

Cost of revenues associated with contract manufacturing decreased in 2005 due to decreased unit production or products we manufacture for third parties. In 2004, cost of revenues increased due to higher costs partially offset by decreased unit production of products we manufacture for third parties.

Operating Costs and Expenses

	For the Years Ended December 31,			Change 2005-2004		Change 2004-2003	
	2005	2004	2003	$	%	$	%
	(in thousands)						
Total gross profit	$ 1,449,896	$ 951,426	$ 1,106,948	$ 498,470	52.4%	$ (155,522)	(14.0)%
Selling, general and administrative	636,483	595,441	490,582	41,042	6.9	104,859	21.4
Research and development	262,726	84,239	238,078	178,487	211.9	(153,839)	(64.6)
Depreciation and amortization	147,049	162,115	113,745	(15,066)	(9.3)	48,370	42.5
Intangible asset impairment	221,054	149,592	124,616	71,462	47.8	24,976	20.0
Merger, restructuring, and other nonrecurring charges	4,180	10,827		(6,647)	(61.4)	10,827	100.0
Gain on sale of products	(1,675)	(9,524)	(12,025)	7,849	82.4	2,501	20.8

Operating income (loss)	$ 180,079	$ (41,264)	$ 151,952	$ 221,343	$ (193,216)

Selling, General and Administrative Expenses

	For the Years Ended December 31,			Change 2005-2004		Change 2004-2003	
	2005	2004	2003	$	%	$	%
	(in thousands)						
Selling, general and administrative, exclusive of co-promotion fees	$ 409,451	$ 409,775	$ 292,084	$ (324)	(0.1)%	$ 117,691	40.3%
Medicaid related charge		65,000		(65,000)	(100.0)	65,000	100.0
Mylan transaction costs	3,898	9,062		(5,164)	(57.0)	9,062	100.0
Co-promotion fees	223,134	111,604	198,498	111,530	99.9	(86,894)	(43.8)
Total selling, general and administrative	$ 636,483	$ 595,441	$ 490,582	$ 41,042	6.9%	$ 104,859	21.4%

Total selling, general and administrative expenses increased in 2005 compared to 2004 primarily due to an increase in co-promotion fees we paid to Wyeth under our Co-Promotion Agreement as a result of higher net sales of Altace® during 2005 as compared to 2004, which were partially offset by a lower net charge for special items affecting this category of expense in 2005 compared to 2004. For a discussion regarding the increase in net sales of Altace®, please see Altace® within the Sales of Key Products section above.

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In 2004, total selling, general and administrative expenses increased from 2003 primarily due to operating expenses associated with the expansion of our sales and marketing organization, increased expenses associated with special items, and increased marketing expenses associated with marketing campaigns for some of our products, which together were substantially offset by decreases in co-promotion fees we paid to Wyeth under our Co-Promotion Agreement as a result of lower sales of Altace® during 2004, as compared to 2003.

Selling, general and administrative expense includes the following special items:

Charges of $19.8 million, $24.8 million, and $28.9 million during 2005, 2004 and 2003, respectively, primarily due to professional fees related to the now completed investigation of our company by the HHS/ OIG, and the partially completed investigation by the SEC. For additional information, please see Settlement of Governmental Pricing Investigation , SEC Investigation and Securities and ERISA Litigation in Item 3, Legal Proceedings.

Charges in the amount of $3.9 million and $9.1 million in 2005 and 2004, respectively, for professional fees and expenses related to the terminated merger agreement with Mylan Laboratories, Inc.

A charge of $65.0 million related to Medicaid in the first half of 2004 to cover estimated interest, costs, fines, penalties and all other settlement costs in addition to the $65.4 million charge that we accrued in 2003 for estimated underpayments to Medicaid and other government pricing programs. We believe that this accrual totaling $130.4 million is adequate and sufficient to cover the full cost of all sums owed the federal and state governments pursuant to the settlement agreements. For additional information, please see Settlement of Governmental Pricing Investigation in Item 3, Legal Proceedings.

As a percentage of total revenues, total selling, general, and administrative expenses decreased to 35.9% in 2005 compared to 45.6% in 2004. Selling, general and administrative expense, as a percentage of total revenues, was higher in 2004 than in 2005 primarily due to lower total revenues in 2004 as a result of a higher level of wholesale channel inventory reductions of some of our branded pharmaceutical products and a higher level of expense associated with special items affecting this category of expense in 2004 compared to 2005 as discussed above.

As a percentage of total revenues, total selling, general, and administrative expense increased to 45.6% in 2004 from 32.9% in 2003. The increased percentage in 2004 was primarily due to lower total revenues in 2004 for the reasons discussed above and an increase in special items affecting this category of expense in 2004 compared to 2003 discussed above.

Research and Development Expense

	For the Years Ended December 31,			Change	
	2005	2004	2003	2005-2004 $	2004-2003 $
	(in thousands)				
Research and development	$ 74,015	$ 67,939	$ 44,078	$ 6,076	$ 23,861
Research and development in process upon acquisition	188,711	16,300	194,000	172,411	(177,700)
Total research and development	$ 262,726	$ 84,239	$ 238,078	$ 178,487	$ (153,839)

Research and development represents expenses associated with the ongoing development of investigational drugs and product life-cycle management projects in our research and development pipeline. These expenses have continued to increase over time as our development programs have progressed to later stages of clinical development, which later stages are much more expensive than earlier stages, and as we have continued to add late-stage products in

development to our portfolio. Our business model continues to focus on adding to our research and development pipeline through the acquisition of novel branded pharmaceutical products and technologies in later stages of development. Accordingly, we anticipate that this category of expense will continue to increase in 2006.

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Research and development-in process upon acquisition represents the actual cost of acquiring rights to novel branded pharmaceutical projects in development from third parties, which costs we expense at the time of acquisition. We classify these costs as special items and in 2005, 2004, and 2003 included the following:

A charge equaling $153.7 million during 2005 for our acquisition of in-process research and development associated with our strategic alliance with Pain Therapeutics to develop and commercialize Remoxy™ and other abuse-resistant opiod painkillers. Remoxy™ is an investigational drug in late-stage clinical development by Pain Therapeutics for the treatment of moderate-to-severe chronic pain. We are responsible for all research and development expenses related to this alliance, which could total $100.0 million. The value of the in-process research and development project was expensed on the date of acquisition as it had not received regulatory approval and had no alternative future use. Remoxy™ is in a Phase III clinical trial. If this Phase III clinical trial is successful, we currently anticipate obtaining FDA approval in 2008 or 2009. We believe there is a reasonable probability of completing the project successfully. However, the success of the project depends on the outcome of the Phase III clinical trial and the ability to successfully manufacture the product. If the project is not successfully completed, it could have a material effect on our cash flows and results of operations.

A charge of $35.0 million during 2005 for our acquisition of in-process research and development due to our co-exclusive license agreement with Mutual Pharmaceutical Company whereby we obtained a license to certain intellectual property relating to metaxalone. The intellectual property licensed to us relates to the potential for improved dosing and administration of metaxalone. The value of the in-process research and development project was expensed on the date of acquisition as it had not received regulatory approval. We are in the process of evaluating a potential new formulation of Skelaxin®. The success of the project will depend on additional in vitro and in vivo work in a clinical setting. The costs and the time-line of the potential project are being evaluated. The in-process research and development is part of the branded pharmaceutical segment.

A charge of $16.3 million during 2004 for our acquisition of in-process research and development associated with our entry into a strategic alliance with Palatin to develop and commercialize PT-141.

A charge of $194.0 million during 2003 for in-process research and development associated with our acquisition of Sonata® and Skelaxin®.

Depreciation and Amortization Expense

Depreciation and amortization expense decreased in 2005 from 2004 primarily due to completing our amortization of the purchase price associated with our Skelaxin® patent in the second quarter of 2005. For additional information regarding amortization, including estimated future amortization expense, please see Note 11 to our audited consolidated financial statements.

Depreciation and amortization expense increased in 2004 from 2003 primarily due to the amortization of the intangible assets associated with our acquisitions of Sonata® and Skelaxin® on June 12, 2003.

Other Operating Expenses

In addition to the special items described above, we incurred other special items affecting operating costs and expenses resulting in a net charge totaling $223.6 million during 2005 compared to a net charge totaling $150.9 million during 2004 and $112.6 million in 2003. These other special items included the following:

An intangible asset impairment charge in 2005 of $221.1 million, which is primarily related to greater than expected decline in prescriptions for Sonata® and anticipated decline in prescriptions in Corzide®. An intangible asset impairment charge in 2004 of $149.6 million, which primarily related to our decision to discontinue the Sonata® MR development program, and a greater than expected

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decline in prescriptions for Florinef® and Tapazole® due to availability of generics for these products. An intangible asset impairment charge of $124.6 million in 2003 primarily reflecting the reduction in the fair value of the Florinef® intangible assets upon the FDA s approval of a second generic on January 21, 2003. The additional intangible asset impairment charge pertaining to Florinef® recorded in 2004 reflects a further reduction in the fair value of the intangible assets associated with this product due to a decline in prescriptions that exceeded our original estimate. These special items were recorded in order to adjust the carrying value of the intangible assets on our balance sheet associated with these products so as to reflect the estimated fair value of these assets at the relevant time.

Restructuring charges in the amount of $2.3 million in 2005 due to a decision to reduce our workforce in order to improve efficiencies in our operations. Restructuring charges in the amount of $1.9 million and $10.8 million in 2005 and 2004, respectively, primarily as a result of separation agreements with several of our executives, the relocation of our sales and marketing operations from Bristol, Tennessee to Princeton, New Jersey and our decision to discontinue some relatively insignificant products associated with Meridian Medical Technologies business.

Income of $1.7 million and $9.5 million in 2005 and 2004, respectively, primarily due to a gain on our divestiture of our Anusol-HC® and Proctocort® product lines and a gain on the termination of our co-promotion and license agreements with Novavax Inc. regarding Estrasorb™ and the repurchase by Novavax of all of its convertible notes which we held.

During 2003, we had income of $12.0 million due to a gain on the sale of our animal health products and certain non-income producing intangible assets.

Demand for some of our non-key products, including but not limited to Intal®, Tilade® and Synercid®, declined over the past year at a rate which triggered a review of the intangible assets associated with these products. As of December 31, 2005, the net intangible assets associated with these three products totaled approximately $196.7 million. We believe that these intangible assets are not currently impaired based on estimated undiscounted cash flows associated with these assets. However, if demand for the products associated with these intangible assets declines below current expectations, we may have to reduce the estimated remaining useful life and/or write off a portion or all of these intangible assets.

In addition, certain generic companies have challenged patents on Altace®, Skelaxin®, and Sonata®. For additional information, please see the sections entitled Altace® Patent Challenge , Skelaxin® Patent Challenge , and Sonata Patent Challenge in Item 3 Legal Proceedings. If a generic version of Altace®, Skelaxin® or Sonata® enters the market, we may have to write-off a portion or all of the intangible assets associated with these products.

Our Rochester, Michigan facility manufactures products for us and various third-parties. As of December 31, 2005, the net carrying value of the property, plant and equipment at the Rochester facility, excluding that associated with the production of Bicillin®, was $66.0 million. Overall production volume at this facility has been declining. We are currently transferring to this facility the manufacture of certain products that are currently manufactured by us at other facilities or for us by third parties. These transfers should increase production and cash flow at the Rochester facility. We currently believe that the long-term assets associated with the Rochester facility are not impaired based on estimated undiscounted future cash flows. However, if production volumes continue to decline or if we are not successful in transferring additional production to the Rochester facility, we may have to write-off a portion of the property, plant, equipment associated with this facility.

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NON-OPERATING ITEMS

	For the Years Ended December 31,		
	2005	2004	2003
		(in thousands)	
Interest income	$ 18,175	$ 5,974	$ 6,849
Interest expense	(11,931)	(12,588)	(13,396)
Valuation charge convertible notes receivable		(2,887)	18,551
(Loss) gain on investment	(6,182)	(6,520)	
Other, net	(2,026)	(749)	(629)
Income tax expense (benefit)	61,485	(7,412)	65,884
Discontinued operations	1,203	(109,666)	(5,489)

Other Income (Expense)

Interest income increased during 2005 compared to 2004 primarily due to an increase in interest rates and a higher total balance of cash, cash equivalents and investments in debt securities in 2005.

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

Charges of $6.2 million and $6.5 million in 2005 and 2004, respectively, related to our investment in Novavax. During 2005 and 2004, we incurred charges to write down our investment in Novavax to fair value. During the third quarter of 2005, we sold our investment in Novavax.

A charge of $2.9 million during 2004 and income of $18.6 million in 2003 to reflect a change in the valuation allowance for the convertible notes receivable from Novavax. Novavax repurchased the convertible notes from us in July 2004.

Income Tax Expense (Benefit)

During 2005, our effective income tax rate for continuing operations was 34.5%. This rate differs from the federal statutory rate of 35% primarily due to tax benefits related to charitable contributions of inventory and tax-exempt interest income partially offset by state taxes. We anticipate our effective tax rate in 2006 to approximate the federal statutory rate.

During 2004, we had an effective income tax benefit rate of 12.8%, which is lower than the federal statutory rate due to the expected nondeductible Medicaid related charges, state taxes, and the establishment of a valuation allowance against state deferred tax assets related to asset impairments.

In 2003, we had an effective income tax rate of 40.3% which is greater than the federal statutory rate primarily due to state income taxes and non-deductible in-process research and development charges incurred in connection with our acquisition of Meridian Medical Technologies.

Discontinued Operations

During the first quarter of 2004, our Board of Directors approved management s decision to market for divestiture some of our women s health products, including Prefest® and Nordette®, which we sold in the fourth quarter of 2004. These product rights had identifiable cash flows that were largely independent of the cash flows of other groups of assets and liabilities and are classified as discontinued operations. Accordingly, all net sales, cost of revenues, selling, general and administrative costs, amortization and other operating costs associated with Prefest® and Nordette® are included in discontinued operations in 2005, 2004 and 2003.

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Off Balance Sheet Arrangements, Contractual Obligations and Commercial Commitments

We do not have any off balance sheet arrangements, except for operating leases in the normal course of business as described in Note 12 to our audited consolidated financial statements included in this report and as reflected in the table below.

The following table summarizes contractual obligations and commitments as of December 31, 2005 (in thousands):

	Payment Due by Period				
	Total	Less Than One Year	One to Three Years	Four to Five Years	More Than Five Years
Contractual Obligations:					
Long-term debt	$ 345,000	$ 345,000	$	$	$
Operating leases	86,628	19,170	34,519	29,625	3,314
Unconditional purchase obligations	356,492	151,495	204,751	225	21
Interest on current portion of long-term debt	8,275	8,275			
Total	$ 796,395	$ 523,940	$ 239,270	$ 29,850	$ 3,335

Our unconditional purchase obligations are primarily related to minimum purchase requirements under contracts with suppliers to purchase raw materials and finished goods related to our branded pharmaceutical products. The above table does not reflect any potential milestone payments in connection with research and development projects or acquisitions.

We have a supply agreement with a third party to produce ramipril, the active ingredient in Altace®. This supply agreement is reflected in the unconditional purchase obligations above. This supply agreement requires us to purchase certain minimum levels of ramipril as long as we maintain market exclusivity on Altace® in the United States, and thereafter the parties must negotiate in good faith the annual minimum purchase quantities. If sales of Altace® do not increase, if we are unable to maintain market exclusivity for Altace® in accordance with our current expectations, if our product life cycle management is not successful, or if the supply agreement or the annual minimum purchase commitments do not terminate at an optimal time for us, we may incur losses in connection with the purchase commitments under the supply agreement. In the event we incur losses in connection with the purchase commitments under the supply agreement, there may be a material adverse effect upon our results of operations and cash flows.

We have commitments to purchase metaxalone, the active ingredient in Skelaxin®, from two suppliers in the form of purchase orders. These outstanding purchase orders are reflected in the unconditional purchase obligations above. If sales of Skelaxin® do not continue as currently anticipated, we may incur losses in connection with the purchase commitments. In the event we incur losses in connection with the purchase commitments under these purchase orders, there may be a material adverse effect upon our results of operations and cash flows.

Liquidity and Capital Resources

General

We believe that existing balances of cash, cash equivalents, investments in debt securities and marketable securities, cash generated from operations, our existing revolving credit facility and funds potentially available to us under our universal shelf registration 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, and numerous circumstances, including a significant acquisition of a business or assets, new product development projects, expansion opportunities, or other factors, could require us to raise additional funds in the future. We cannot assure you that funds will be available to us when needed on favorable terms, or at all.

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In March 2006, we acquired substantially all of the assets of Allerex Laboratory LTD for $25.0 million, less an adjustment in the purchase price resulting in an initial payment of $23.4 million, plus an earn-out based on sales of EpiPen® in Canada. The primary asset purchased from Allerex was the exclusive right to market and sell EpiPen® throughout Canada. We further negotiated with Dey, L.P., an extension of those exclusive rights to market and sell EpiPen® in Canada through 2015.

In February 2006, we entered into a collaboration with Arrow International Limited and certain of its affiliates (collectively, Arrow) to commercialize novel formulations of ramipril, the active ingredient in our Altace® product. Under a series of agreements, Arrow has granted us rights to certain current and future New Drug Applications (NDAs) regarding novel formulations of ramipril and intellectual property, including patent rights and technology licenses relating to these novel formulations. Under certain conditions, Arrow will be responsible for the manufacture and supply of new formulations of ramipril for us. Additionally, we have granted Cobalt Pharmaceuticals, Inc. a non-exclusive right to enter into the U.S. ramipril market with a generic form of the currently marketed Altace® product, which would be supplied by us. Cobalt is an affiliate of Arrow, but is not a party to the collaboration.

Pursuant to the agreements, we made an upfront payment to Arrow of $35.0 million. Arrow will also receive payments from us of $50.0 million based on the timing of certain events and could receive an additional $25.0 million based on the occurrence of certain conditions. Additionally, Arrow will earn fees for the manufacture and supply of new formulations of ramipril.

In December 2005, we entered into a cross-license agreement with Mutual Pharmaceutical Company, Inc. (Mutual). 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. We will pay royalties on net sales of products containing metaxalone beginning January 1, 2006. This royalty may increase depending on the achievement of certain regulatory and commercial milestones. The royalty we pay to Mutual is in addition to the royalty we pay to Elan on our current formulation of metaxalone, which we refer to as Skelaxin® which is a part of our branded pharmaceutical segment.

During the fourth quarter of 2005, the Company entered into a strategic alliance with Pain Therapeutics to develop and commercialize Remoxy™ and other abuse-resistant opioid painkillers. Remoxy™ is an investigational drug in late-stage clinical development by Pain Therapeutics for the treatment of moderate-to-severe chronic pain. Under the strategic alliance, we may pay additional milestone payments of up to $150.0 million in cash based on the successful clinical and regulatory development of Remoxy™ and other abuse-resistant opioid products. This includes a $15.0 million cash payment upon acceptance of a regulatory filing for Remoxy™ and an additional $15.0 million upon its approval. We are responsible for all research and development expenses related to this alliance, which could total $100.0 million over four years. After regulatory approval and commercialization of Remoxy™ or other products developed through this alliance, we will pay a royalty of 15% of the cumulative net sales up to $1.0 billion and 20% of the cumulative net sales over $1.0 billion.

In August 2004, we entered into a collaborative agreement with Palatin to jointly develop and, on obtaining necessary regulatory approvals, commercialize Palatin s PT-141 for the treatment of male and female sexual dysfunction. In connection with this agreement, we agreed to pay potential milestone payments to Palatin of up to $100.0 million upon achieving certain development and regulatory approval targets, $10.0 million of which was paid during 2005. Following regulatory approval and commercialization of PT-141, we may also pay potential net sales milestone payments to Palatin of up to $130.0 million.

Elan was working to develop a modified release formulation of Sonata®, which we refer to as Sonata® MR, pursuant to an agreement we had with them which we refer to as the Sonata® MR Development Agreement. In early 2005, we advised Elan that we considered the Sonata® MR Development Agreement terminated. On August 26, 2005, Elan filed a request for mediation pursuant to the terms of the Sonata® MR Development Agreement. We participated in mediation with Elan in early 2006, which did not result in an agreed resolution. The Sonata® MR Development Agreement requires us to pay up to an additional $60.0 million if Elan achieves certain milestones in connection with the development of a reformulated version of Sonata® and $15.0 million as a milestone payment if annual net sales of a reformulated version of

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Sonata® exceed $100.0 million, plus costs associated with the development of a reformulated version of Sonata®. We believe these milestones have not and cannot in the future be achieved.

As additional consideration for Synercid®, an injectable antibiotic acquired on December 30, 2002, we agreed to potential milestone payments. An additional $25.0 million milestone is payable to Sanofi-Aventis if Synercid® should receive FDA approval to treat methicillin resistant staphylococcus aureus, or we will pay Sanofi-Aventis a one-time payment of $5.0 million the first time during any twelve-month period that net sales of Synercid® exceed $60.0 million, and a one-time payment of $20.0 million the first time during any twelve-month period that net sales of Synercid® exceed $75.0 million.

Settlement of Governmental Pricing Investigation

On October 31, 2005, we entered into (i) a definitive settlement agreement with the United States of America, acting through the United States Department of Justice and the United States Attorney s Office for the Eastern District of Pennsylvania and on behalf of the Office of Inspector General of the United States Department of Health and Human Services (HHS/ OIG) and the Department of Veterans Affairs, to resolve the governmental investigations related to our underpayment of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002 (the Federal Settlement Agreement), and (ii) similar settlement agreements with 48 states and the District of Columbia (collectively, the State Settlement Agreements , and together with the Federal Settlement Agreement, the Settlement Agreements). We have agreed to a settlement with the remaining state on substantially the same terms as the other state settlements, and we currently expect to enter into a definitive settlement agreement with that state before the end of the first quarter of 2006. Consummation of the Federal Settlement Agreement and some State Settlement Agreements is or was subject to court approval. On February 24, 2006, the United States District Court for the Eastern District of Pennsylvania (District Court) approved the Federal Settlement Agreement. All interested parties, including King, the individual purportedly acting as a relator under the False Claims Act and the affected states, have requested that the District Court approve the State Settlement Agreements that require court approval.

Pursuant to the Settlement Agreements, we agreed to pay a total of approximately $124.1 million (the Settlement Amount) and interest on the Settlement Amount at the rate of 3.75% from July 1, 2005 to the date of consummation of the settlement. We have further agreed to pay, subject to certain conditions, (i) legal fees relating to the settlement in the amount of approximately $0.8 million, and (ii) approximately $1.0 million in settlement costs. The Settlement Amount includes approximately $50.6 million of the Settlement Amount for payment to 49 states and the District of Columbia. The Settlement Amount includes approximately $63.7 million representing the amount of underpayments to Medicaid and other governmental pricing programs from 1994 to 2002 and approximately $60.4 million to cover interest, penalties and other costs. We currently expect to pay the Settlement Amount and the other amounts described above.

On March 2, 2006, we paid approximately $126.9 million, comprising the Settlement Amount and accrued interest under our Settlement Agreements with the United States and the 48 states and the District of Columbia. We have agreed to pay approximately $0.4 million to the remaining state. We currently expect to make this payment and the other remaining payments by the end of the first quarter of 2006.

Certain decisions of the District Court relating to the relator s dispute with certain states over a potential share award remain subject to appeal. Any share award would be paid solely by the government and would not affect the amount we are required to pay pursuant to the settlement. Consequently, we believe the reversal of any such decision or decisions would not have a material effect on us.

In addition to the Settlement Agreements, we have entered into a five-year corporate integrity agreement with HHS/ OIG (the Corporate Integrity Agreement) pursuant to which we are required, among other things, to keep in place our current compliance program, to provide periodic reports to HHS/ OIG and to submit to audits relating to our Medicaid rebate calculations.

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We accrued in prior years a total of $130.4 million in respect of our estimated underpayments to Medicaid and other governmental pricing programs and estimated settlement costs with all relevant governmental parties, which sum is classified as restricted cash and an accrued expense on our balance sheet. This sum is sufficient to cover the full cost of all sums owed the federal and state governments pursuant to the Settlement Agreements, together with related obligations to reimburse the expenses of some of the parties.

The previously disclosed claim seeking damages from us because of alleged retaliatory actions against the relator was dismissed with prejudice on January 31, 2006.

The Settlement Agreements will not resolve any of the previously disclosed civil suits that are pending against us and related individuals and entities discussed in the section Securities and ERISA Litigation below.

The foregoing description of the settlement, the Settlement Agreements and the Corporate Integrity Agreement is qualified in its entirety by the Company s Current Report on Form 8-K filed November 4, 2005, which is incorporated herein by reference.

SEC Investigation

As previously reported, the SEC has also been conducting an investigation relating to our underpayments to governmental programs, as well as into our previously disclosed errors relating to reserves for product returns. While the SEC s investigation is continuing with respect to the product returns issue, the Staff of the SEC has advised us that it has determined not to recommend enforcement action against us with respect to the aforementioned governmental pricing matter. The Staff of the SEC notified King of this determination pursuant to the final paragraph of Securities Act Release 5310. Although the SEC could still consider charges against individuals in connection with the governmental pricing matter, we do not believe that any governmental unit with authority to assert criminal charges is considering any charges of that kind.

We continue to cooperate with the SEC s ongoing investigation. Based on all information currently available to us, we do not anticipate that the results of the SEC s ongoing investigation will have a material adverse effect on King, including by virtue of any obligations to indemnify current or former officers and directors.

Securities and ERISA Litigation

Subsequent to the announcement of the SEC investigation described above, beginning in March 2003, 22 purported class action complaints were filed by holders of King s securities against the Company, its directors, former directors, executive officers, former executive officers, King s subsidiary, and a former director of the subsidiary in the United States District Court for the Eastern District of Tennessee, alleging violations of the Securities Act of 1933 and/or the Securities Exchange Act of 1934, in connection with our underpayment of rebates owed to Medicaid and other governmental pricing programs, and certain transactions between us and the Benevolent Fund. These 22 complaints have been consolidated in the United States District Court for the Eastern District of Tennessee. In addition, holders of King s securities filed two class action complaints alleging violations of the Securities Act of 1933 in Tennessee state court. King removed these two cases to the United States District Court for the Eastern District of Tennessee, where these two cases were consolidated with the other class actions. Plaintiffs in these actions unsuccessfully moved to remand these two cases back to Tennessee state court. These two actions therefore remain part of the consolidated action. The district court has appointed lead plaintiffs in the consolidated action, and those lead plaintiffs filed a consolidated amended complaint on October 21, 2003 alleging that King, through some of its executive officers, former executive officers, directors, and former directors, made false or misleading statements concerning its business, financial condition, and results of operations during periods beginning February 16, 1999 and continuing until March 10, 2003. Plaintiffs in the consolidated action have also named the underwriters of King s November 2001 public offering as

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defendants. The Company and other defendants filed motions to dismiss the consolidated amended complaint.

On August 12, 2004, the United States District Court for the Eastern District of Tennessee ruled on defendants motions to dismiss. The Court dismissed all claims as to Jones and as to defendants Dennis Jones and Henry Richards. The Court also dismissed certain claims as to five other individual defendants. The Court denied the motions to dismiss in all other respects. Following the Court s ruling, on September 20, 2004, the Company and the other remaining defendants filed answers to plaintiffs consolidated amended complaint. Discovery in this action has commenced. The Court has set a trial date of April 10, 2007.

We have estimated a probable loss contingency for the class action lawsuit described above. We believe this loss contingency will be paid on behalf of us by our insurance carriers. Accordingly, as of December 3, 2005, we have recorded a liability and a receivable for this amount, classified in accrued expenses and prepaid and other current assets, respectively, in our consolidated financial statement.

Beginning in March 2003, four purported shareholder derivative complaints were also filed in Tennessee state court alleging a breach of fiduciary duty, among other things, by some of our current and former officers and directors, with respect to the same events at issue in the federal securities litigation described above. These cases have been consolidated, and on October 3, 2003, plaintiffs filed a consolidated amended complaint. On November 17, 2003, defendants filed a motion to dismiss or stay the consolidated amended complaint. The court denied the motion to dismiss, but granted a stay of proceedings. On October 11, 2004, the court lifted the stay to permit plaintiffs to file a further amended complaint adding class action claims related to our then-anticipated merger with Mylan Laboratories, Inc. On October 26, 2004, defendants filed a partial answer to the further amended complaint, and moved to dismiss the newly-added claims. Following the termination of the Mylan merger agreement, plaintiffs voluntarily dismissed these claims. Discovery with respect to the remaining claims in the case has commenced. No trial date has been set.

Beginning in March 2003, three purported shareholder derivative complaints were likewise filed in Tennessee federal court, asserting claims similar to those alleged in the state derivative litigation. These cases have been consolidated, and on December 2, 2003 plaintiffs filed a consolidated amended complaint. On March 9, 2004, the court entered an order indefinitely staying these cases in favor of the state derivative action.

In August 2004, a separate class action lawsuit was filed in Tennessee state court, asserting claims solely with respect to our then-anticipated merger with Mylan Laboratories. Defendants filed a motion to dismiss the case on November 30, 2004, which remains pending. We believe that the claims in this case are moot following termination of the Mylan merger agreement.

Additionally, a class action complaint was filed in the United States District Court for the Eastern District of Tennessee under the Employee Retirement Income Security Act (ERISA). As amended, the complaint alleges that King and certain of its executive officers, former executive officers, directors, former directors and an employee of King violated fiduciary duties that they allegedly owed King s 401(k) Retirement Savings Plan s participants and beneficiaries under ERISA. The allegations underlying this action are similar in many respects to those in the class action litigation described above. The defendants filed a motion to dismiss the ERISA action on March 5, 2004. The District Court Judge referred the motion to a Magistrate Judge for a report and recommendation. On December 8, 2004, the Magistrate Judge held a hearing on this motion, and, on December 10, 2004, he recommended that the District Court Judge dismiss the action. The District Court Judge accepted the recommendation and dismissed the case on February 4, 2005. The plaintiffs have not appealed this decision, and the deadline for filing any appeal has now passed.

We are unable currently to predict the outcome or to reasonably estimate the range of potential loss, if any, except as noted above, in the pending litigation. If we were not to prevail in the pending litigation,

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or if any governmental sanctions are imposed in excess of those described above, neither of which we can predict or reasonably estimate at this time, our business, financial condition, results of operations and cash flows could be materially adversely affected. Responding to the government investigations and defending us in the pending litigation has resulted, and is expected to continue to result, in a significant diversion of management s attention and resources and the payment of additional professional fees.

Patent Challenges

Certain generic companies have challenged patents on Altace®, Skelaxin®, Sonata® and Adenoscan®. For additional information, please see Altace® Patent Challenge , Skelaxin® Patent Challenge , Sonata® Patent Challenge, and Adenoscan® Patent Challenge in Item 3, Legal Proceedings. If a generic version of Altace®, Skelaxin®, Sonata® or Adenoscan® enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Cash Flows

Operating Activities

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Net cash provided by operating activities	$ 519,510	$ 260,907	$ 435,686

Our net cash provided by operations was higher in 2005 than in 2004 primarily due to an increase in the gross profit margin, driven by an increase in net sales of branded pharmaceutical products. This was partially offset by an increase in the co-promotion fees and working capital changes outlined below.

Our net cash provided by operations was lower in 2004 than in 2003 primarily due to a decrease in the gross profit margin, driven by a decrease in net sales of branded pharmaceutical products, and higher selling, general and administrative expenses. The overall decrease was partially offset by a decrease in the co-promotion fees and working capital changes outlined below.

Please see the section entitled Operating Results for a discussion of net sales, selling, general and administrative expenses and co-promotion fees.

The following table summarizes the changes in operating assets and liabilities and deferred taxes for the periods ending 2005, 2004 and 2003:

	2005	**2004**	**2003**
Accounts receivable, net of allowance	$ (43,407)	$ 57,978	$ (84,186)
Inventories	46,349	(15,205)	(52,855)
Prepaid expenses and other current assets	(47,544)	(16,161)	27,307
Accounts payable	(7,713)	9,197	33,958
Accrued expenses and other liabilities	(52,544)	43,566	92,798
Income taxes payable	22,161	(78,708)	60,554
Deferred revenue	(9,092)	(9,091)	(9,092)
Other assets	(4,471)	(3,483)	(2,978)
Deferred taxes	(68,047)	(17,083)	(139,598)
Total changes from operating assets and liabilities and deferred taxes	$ (164,308)	$ (28,990)	$ (74,092)

We anticipate lower net cash provided by operating activities in 2006 than that experienced in 2005 primarily due to increased taxes, increased investment in research and development and increased royalty commitments.

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Investing Activities

	For the Years Ended December 31,		
	2005	2004	2003
Net cash (used in) investing activities	$ (683,007)	$ (154,071)	$ (459,444)

Investing activities in 2005 were driven by payments totaling $198.7 million for our collaboration agreements with Pain Therapeutics and Palatin and our cross-license agreement with Mutual. Capital expenditures during 2005 totaled $53.3 million which included property, plant and equipment purchases, building improvements for facility upgrades and costs associated with improving our production capabilities, and costs associated with moving production of some of our pharmaceutical products to our facilities in St. Louis, Bristol and Rochester. Additionally in 2005, we transferred $73.6 million to restricted cash primarily related to the now completed investigation of our Company by the HHS/OIG. We increased our investments in debt securities by $345.2 million.

Investing activities in 2004 were driven by payments totaling $78.2 million for our collaboration agreement with Palatin and, milestone payments associated with the acquisitions of primary care business of Elan and Synercid®. Capital expenditures during 2004 totaled $55.1 million which included property, plant and equipment purchases, building improvements for facility upgrades and costs associated with improving our production capabilities, and costs associated with moving production of some of our pharmaceutical products to our facilities in St. Louis, Bristol and Rochester. Additionally in 2004, we increased our investments in debt securities by $46.5 million which was partially offset by proceeds of $27.5 million principally from the sale of product rights.

Investing activities in 2003 were driven by acquisition costs totaling $1.0 billion for our purchase of Meridian and the primary care business of Elan. Capital expenditures during 2003 totaled $51.2 million which included property and equipment purchases, new information technology system implementation costs and building improvements for facility upgrades and increased capacity. Additionally in 2003, we transferred $67.7 million to restricted cash which was more than offset by proceeds of $668.7 primarily due to sales of investments in debt securities and marketable securities.

We anticipate capital expenditures, including capital lease obligations, for the year ending December 31, 2006 of approximately $50.0 million, which will be funded with cash from operations. The principal capital expenditures are anticipated to include property and equipment purchases, building improvements for facility upgrades, costs associated with improving our production capabilities, and costs associated with moving production of some of our pharmaceutical products to our facilities in St. Louis, Bristol and Rochester.

Financing Activities

	2005	2004	2003
Net cash provided by financing activities	$ 857	$ 4,580	$ 2,543

Our cash flows from financing activities for all periods are primarily related to the exercise of employee stock options.

Certain Indebtedness and Other Matters

As of December 31, 2005, we had outstanding $345.0 million of 2^{3}/4% Convertible Debentures due November 15, 2021. These debt securities were issued in a private placement in November 2001. Holders may require us to repurchase for cash all or part of these debentures on November 15, 2006, November 15, 2011, and November 15, 2016 at a price equal to 100% of the principal amount of the debentures plus accrued interest up to but not including the date of repurchase. As of December 31, 2005, we have classified the debentures as a current liability due to the right the holders have to require us to repurchase the debentures on November 15, 2006. Alternatively, we may elect to repurchase some or all of the debentures, by negotiation with debenture holders, a buy-back program, or a tender

offer, prior to

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November 15, 2006. The debentures accrue interest at an initial rate of 2 3/4% which will be reset (but not below 2 3/4% or above 4 1/4%) on May 15, 2006.

We also had available as of December 31, 2005 up to $399.0 million under a five-year senior secured revolving credit facility that we established in April 2002. The facility is collateralized in general by all of our real estate with a value of $5.0 million or more and all of our personal property and that of our significant subsidiaries. Our obligations under the senior secured revolving credit facility are unconditionally guaranteed on a senior basis by most of our subsidiaries. The senior secured revolving credit facility accrues interest at our option, at either (a) the base rate, which is based on the greater of (1) the prime rate or (2) the federal funds rate plus one-half of 1%, plus an applicable spread ranging from 0.0% to 0.75% (based on a leverage ratio) or (b) the applicable LIBOR rate plus an applicable spread ranging from 1.0% to 1.75% (based on a leverage ratio). In addition, the lenders under the senior secured revolving credit facility are entitled to customary facility fees based on (a) unused commitments under the facility and (b) letters of credit outstanding. We incurred $5.1 million of deferred financing costs in connection with the establishment of this facility, which are being amortized over five years, the life of the senior secured revolving credit facility. This facility requires us to maintain a minimum net worth of no less than $1.2 billion plus 50% of our consolidated net income for each fiscal quarter after April 23, 2002, excluding any fiscal quarter for which consolidated income is negative; an EBITDA to interest expense ratio of no less than 3.00 to 1.00; and a funded debt to EBITDA ratio of no greater than 3.50 to 1.00 prior to April 24, 2004 and of no greater than 3.00 to 1.00 on or after April 24, 2004. As of December 31, 2005, we were in compliance with these covenants. As of December 31, 2005, we had $1.0 million outstanding for letters of credit under this facility.

On September 20, 2001, our universal shelf registration statement on Form S-3 was declared effective by the Securities and Exchange Commission. This universal shelf registration statement registered a total of $1.3 billion of our securities for future offers and sales in one or more transactions and in any combination of debt and/or equity. During November 2001, we completed the sale of 17,992,000 newly issued shares of common stock for $38.00 per share ($36.67 per share net of commissions and expenses) resulting in net proceeds of $659.8 million. As of December 31, 2005, there was $616.3 million of securities remaining registered for future offers and sales under the shelf registration statement. However, due to delays in our filings of one or more reports under the Securities Exchange Act of 1934, as amended, we believe that we are not eligible to use a Form S-3 registration statement at the present time. Accordingly, unless and until we regain eligibility to use Form S-3, we are not able to offer and sell securities under our shelf registration statement without first amending it to convert it to the registration statement form, Form S-1, that is currently available to us. Whether or not we seek to raise funds in the public equity or debt markets in the near term, we may decide, or the SEC may require us, to amend our shelf registration statement for the purpose of converting it to a Form S-1.

Impact of Inflation

We have experienced only moderate raw material and labor price increases in recent years. While we have passed some price increases along to our customers, we have primarily benefited from sales growth negating most inflationary pressures.

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

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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 and other rebates, returns and chargebacks, allowances for doubtful accounts and estimates used in applying the revenue recognition policy and accounting for the Co-Promotion Agreement with Wyeth.

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 product rights and trademarks, patents, acquired research and development, if any, and other intangibles using the assistance of valuation experts. 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. However, patents have specific legal lives over which they are amortized. Conversely, trademarks and product rights have no specific legal lives. Trademarks and product rights will continue to be an asset to us after the expiration of the patent, as their economic value is not tied exclusively to the patent. We believe that by establishing separate lives for the patent versus the trademark and product rights, we are in essence using an accelerated method of amortization for the product as a whole. This results in greater amortization in earlier years when the product is under patent protection, as we are amortizing both the patent and the trademark and product rights, and less amortization when the product faces potential generic competition, as the amortization on the patent is eliminated. Because we have no discernible evidence to show a decline in cash flows for trademarks and product rights, or for patents, we use the straight-line method of amortization for both intangibles.

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, 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. Further, on an annual basis, we review the life of each intangible asset and make adjustments as deemed appropriate. 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.

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The gross carrying amount and accumulated amortization as of December 31, 2005 are as follows:

	Cost	Accumulated Amortization	Net Book Value
		(In thousands)	
Branded			
Altace®	$ 276,150	$ 70,214	$ 205,936
Other Cardiovascular/metabolic	80,770	38,130	42,640
Cardiovascular/metabolic	356,920	108,344	248,576
Intal®	106,192	14,864	91,328
Other Hospital/acute care	191,393	44,701	146,692
Hospital/acute care	297,585	59,565	238,020
Skelaxin®	203,015	32,631	170,384
Sonata®	23,146	23,146	
Neuroscience	226,161	55,777	170,384
Other	144,675	53,833	90,842
Total Branded	1,025,341	277,519	747,822
Meridian Medical Technologies	146,217	17,200	129,017
Royalties	2,470	2,082	388
Contract manufacturing			
All other			
Total trademark and product rights	$ 1,174,028	$ 296,801	$ 877,227

The amounts for impairments and amortization expense and the amortization period used for the twelve months ended December 31, 2005 and 2004 are as follows:

	Year Ended December 31, 2005			Year Ended December 31, 2004	
	Impairments	Amortization Expense	Life (Years)	Impairments	Amortization Expense
	(In thousands)			(In thousands)	
Branded					
Altace®	$	$ 13,352	21	$	$ 10,135
Other Cardiovascular/metabolic	43,243	7,672		21,193	6,587
Cardiovascular/metabolic	43,243	21,024		21,193	16,722
Intal®		6,047	15		4,558
Other Hospital/acute care	5,970	9,414		11,672	7,816

Hospital/acute care	5,970	15,461		11,672	12,374
Skelaxin®		15,548	13.5		11,558
Sonata®	157,975	9,117	2.5	82,081	12,635
Neuroscience	157,975	24,665		82,081	24,193
Other		7,823		29,980	8,715
Total Branded	207,188	68,973		144,926	62,004
Meridian Medical Technologies		5,165		3,120	5,885
Royalties		42			42
Contract manufacturing					
All other					
Total trademark and product rights	$ 207,188	$ 74,180		$ 148,046	$ 67,931

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

	Remaining Life at December 31, 2005	
	Patent	Trademark & Product Rights
Altace®	3 years 4 months	14 years
Skelaxin®		11 years
Sonata®	1 year	
Intal®		12 years

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 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 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 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.

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.

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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. Royalty revenue is recognized based on a percentage of sales (namely, contractually agreed-upon royalty rates) reported by third parties. See Note 2, Summary of Significant Accounting Policies, in our Notes to Consolidated Financial Statements included in this report.

Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS No. 123(R), (Share-based Payment) that requires us to expense costs related to share-based payment transactions with employees. The SEC has issued an amendment to Rule 4-01(a) of Regulation S-X, changing the compliance date for SFAS 123(R) to the first annual reporting period beginning on or after June 15, 2005. SFAS No. 123(R) became mandatorily effective on January 1, 2006. Accordingly, we will adopt SFAS 123(R) in the first quarter of 2006. See Note 2 to the consolidated financial statements for the pro-forma effect on net income and earnings per share of applying SFAS 123.

In November 2004, the FASB issued SFAS No. 151, (Inventory Costs), an amendment of ARB No. 43. SFAS No. 151 requires certain abnormal expenditures to be recognized as expenses in the current period. It also requires that the amount of fixed production overhead allocated to inventory be based on the normal capacity of the production facilities. The standard is effective for the fiscal year beginning January 1, 2006. We are currently evaluating the effect that SFAS No. 151 will have on our financial reporting.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to market risk for changes in the market values of some of our investments (Investment Risk) and the effect of interest rate changes (Interest Rate Risk). Our financial instruments are not currently subject to foreign currency risk or commodity price risk. We have no financial instruments held for trading purposes. At December 31, 2005, 2004 and 2003, we did not hold any derivative financial instruments. The quantitative and qualitative disclosures about market risk are set forth below.

Interest Rate Risk

The fair market value (fair value) of long-term fixed interest rate debt is subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of our convertible debentures is affected by our stock price. The estimated fair value of our total long-term debt at December 31, 2005 was $336.6 million. Fair values were determined from available market prices, using current interest rates and terms to maturity. If interest rates were to increase or decrease 1%, the fair value of our long-term debt would increase or decrease by approximately $2.9 million.

Investment Risk

We have marketable securities which are carried at fair value based on current market quotes. Gains and losses on securities are based on the specific identification method.

Item 8. ***Financial Statements and Supplementary Data***

Our audited consolidated financial statements and related notes as of December 31, 2005 and 2004 and for each of the three years ended December 31, 2005, 2004 and 2003 are included under Item 15 and begin on page F-1.

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Item 9. ***Changes in Accountants and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, carried out an evaluation, as required by Rule 13a-15(b) under the Exchange Act, of the effectiveness of the design and operation of the disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of December 31, 2005.

Based on this evaluation by management, the Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2005, our disclosure controls and procedures were effective.

Management s Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Rule 13a-15(f). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2005, based on the framework and criteria established in *Internal Control Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that internal control over financial reporting was effective as of December 31, 2005.

Our independent registered public accounting firm, PricewaterhouseCoopers LLP, audited management s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005 as stated in its report which appears herein.

Changes in Internal Control over Financial Reporting

As discussed in previous 10-Q filings, we made numerous personnel changes including hiring a new Chief Financial Officer and additional managerial level finance and accounting resources to perform supervisory review and monitoring activities. In addition, we have improved the efficiency and effectiveness of our financial closing process through automation, better coordination with external parties, and better organization within the finance and accounting function. As a result, we have implemented additional managerial level finance and accounting supervisory activities during the period-end financial reporting process. As a result of these efforts, we have concluded that the material weakness that existed at December 31, 2004 was fully remediated as of December 31, 2005.

Except as discussed above, there have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2005, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART III

The information called for by Part III of Form 10-K (Item 10 Directors and Executive Officers of the Registrant, Item 11 Executive Compensation, Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, Item 13 Certain Relationships and Related Transactions, and Item 14 Principal Accounting Fees and Services), is incorporated by reference from our proxy statement related to our 2006 annual meeting of shareholders, which will be filed with the SEC not later than April 30, 2006 (120 days after the end of the fiscal year covered by this report).

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PART IV

Item 15. ***Exhibits, Financial Statement Schedules, and Reports on Form 8-K***

(a) Documents filed as a part of this report:

(1) Financial Statements

(2) Financial Statement Schedule Valuation and Qualifying Accounts S-1

All other schedules have been omitted because of the absence of conditions under which they are required or because the required information is given in the above-listed financial statements or notes thereto.

(b) Exhibits

The following Exhibits are filed herewith or incorporated herein by reference:

Exhibit Number	Description
3.1(1)	Second Amended and Restated Charter of King Pharmaceuticals, Inc.
3.2(1)	Amended and Restated Bylaws of King Pharmaceuticals, Inc.
4.1(1)	Specimen Common Stock Certificate.
4.2(1)	Form of Rights Agreement by and between King Pharmaceuticals, Inc. and The Bank of New York (successor in interest to Union Planters National Bank).
10.2(2)	Co-Promotion Agreement, dated as of June 22, 2000, between American Home Products Corporation and King Pharmaceuticals, Inc.
10.3(2)	Asset Purchase Agreement, dated as of June 22, 2000, between American Home Products Corporation and King Pharmaceuticals, Inc.
10.5(4)	Indenture, dated as of November 1, 2001, among King Pharmaceuticals, Inc., certain Subsidiary Guarantors and The Bank of New York, as trustee, relating to King s $2^{3}/4\%$ Convertible Debentures due November 15, 2021.
10.6(6)*	1998 King Pharmaceuticals, Inc. Non-Employee Director Stock Option Plan.
10.7(1)*	

	1997 Incentive and Nonqualified Stock Option Plan for Employees of King Pharmaceuticals, Inc.
10.8(4)*	King Pharmaceuticals, Inc. 401(k) Retirement Savings Plan.
10.9(5)*	The Medco Research, Inc. 1989 Stock Option and Stock Appreciation Rights Plan, as amended through July 29, 1998.
10.10(6)*	1989 Incentive Stock Option Plan of Jones Medical Industries, Inc.
10.11(6)*	Jones Medical Industries, Inc. 1994 Incentive Stock Plan.
10.12(6)*	Jones Medical Industries, Inc. 1997 Incentive Stock Plan.

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Exhibit Number	Description
10.13(7)	Credit Agreement dated as of April 23, 2002, among King Pharmaceuticals, Inc., and the Lenders therein, Credit Suisse First Boston, Cayman Islands Branch, as Administrative Agent, as Collateral Agent and as Swingline Lender, and Bank of America, NA, J.P. Morgan Securities Inc., and UBS Warburg LLC as Co-Syndication Agents, Wachovia Bank National Association, as Documentation Agent, Credit Suisse First Boston as Sole Lead Arranger and Bookrunner.
10.14(8)	Amended and Restated Asset Purchase Agreement by and among Elan Corporation, plc, Elan Pharma International Limited, Elan Pharmaceuticals, Inc., Jones Pharma Incorporated and Monarch Pharmaceuticals, Inc. dated as of May 19, 2003.
10.15(9)*	King Pharmaceuticals, Inc. Non-Employee Directors Deferred Compensation Plan.
10.16(10)*	Offer Letter to Brian A. Markison, dated July 15, 2004.
10.17(10)	Collaborative Development and Marketing Agreement dated August 12, 2004 by and between Palatin Technologies, Inc. and King Pharmaceuticals, Inc.
10.18(11)*	King Pharmaceuticals, Inc. Severance Pay Plan: Tier I (Effective March 15, 2005)
10.19(12)*	Offer letter to Joseph Squicciarino dated May 25, 2005.
10.20(12)*	Offer letter to Eric J. Bruce dated May 19, 2005.
10.21(12)*	2005 Executive Management Incentive Award
10.22(18)*	King Pharmaceuticals, Inc. Incentive Plan.
10.23(19)*	Compensation Policy for Non-Employee Directors
10.24(12)*	Salary Amendments For Certain Executive Officers
10.25(12)*	King Pharmaceuticals, Inc. Executive Deferred Compensation Plan
10.26(13)*	Form of Restricted Stock Certificate and Restricted Stock Grant Agreement
10.27(13)*	Form of Option Certificate and Nonstatutory Stock Option Agreement.
10.28(14)	Settlement Agreement, dated as of October 31, 2005, among the United States of America acting through the entities named therein, King Pharmaceuticals, Inc. and Monarch Pharmaceuticals, Inc.
10.29(14)	Settlement Agreement, dated as of October 31, 2005, among the state of Massachusetts, King Pharmaceuticals, Inc. and Monarch Pharmaceuticals, Inc. and general description of the other state settlement agreements.

10.30(14)	Corporate Integrity Agreement, dated as of October 31, 2005, between the Office of Inspector General of the Department of Health and Human Services and King Pharmaceuticals, Inc.
10.31(15)*	Retirement and Consulting Agreement, dated as of April 1, 2005, and Waiver, Release and Non-Solicitation, Noncompete and Nondisclosure Agreement, dated as of May 12, 2005, by and between King Pharmaceuticals, Inc. and James R. Lattanzi.
10.32(16)*	First Amendment to Retirement and Consulting Agreement, dated as of November 4, 2005, by and between the Company and James R. Lattanzi.
10.33*	Waiver, Release and Non-Solicitation, NonCompete and Nondisclosure Agreement, dated as of November 1, 2005, by and between King Pharmaceuticals, Inc. and John A. A. Bellamy
10.34*	Addendum to the Waiver, Release and Non-Solicitation, Noncompete and Nondisclosure Agreement, dated as of December 20, 2005, by and between the Company and John A. A. Bellamy
10.35	Collaboration Agreement by and between the Issuer and Pain Therapeutics, Inc., dated as of November 9, 2005
10.36	License Agreement by and between the Issuer and Pain Therapeutics, Inc., dated as of December 29, 2005
10.37	License Agreement, by and between the Issuer and Mutual Pharmaceutical Company, Inc., dated as of December 6, 2005

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Exhibit Number	Description
10.38*	Severance letter to John A. A. Bellamy dated October 14, 2005.
14.1(17)	Corporate Code of Conduct and Ethics.
21.1	Subsidiaries of the Registrant.
23.1	Consent of PricewaterhouseCoopers LLP.
31.1	Certificate of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certificate of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Denotes management contract or compensatory plan or arrangement.
Portions of this Exhibit have been omitted and filed separately with the Securities and Exchange Commission as part of an application for confidential treatment pursuant to the Securities Exchange Act of 1934.

(1) Incorporated by reference to King s Registration Statement on Form S-1 (Registration No. 333-38753) filed October 24, 1997.

(2) Incorporated by reference to King s Current Report on Form 8-K filed June 30, 2000.

(3) Incorporated by reference to King s Schedule 13-D filed December 29, 2000, as amended.

(4) Incorporated by reference to King s Registration Statement on Form S-8 filed February 26, 1999.

(5) Incorporated by reference to King s Registration Statement on Form S-8 filed March 9, 2000.

(6) Incorporated by reference to King s Registration Statement on Form S-8 filed September 6, 2000.

(7) Incorporated by reference to King s Quarterly Report on Form 10-Q filed May 14, 2002.

(8) Incorporated by reference to King s Current Report on Form 8-K filed June 13, 2003.

(9) Incorporated by reference to King s Annual Report on Form 10-K for the year ended December 31, 2003.

(10) Incorporated by reference to King s Quarterly Report on Form 10-Q filed March 21, 2005.

(11) Incorporated by reference to King s Current Report on Form 8-K filed March 21, 2005.

(12) Incorporated by reference to King s Quarterly Report on Form 10-Q filed August 9, 2005.

(13) Incorporated by reference to King s Quarterly Report on Form 10-Q filed November 9, 2005.

(14) Incorporated by reference to King s Current Report on Form 8-K filed November 4, 2005.

(15) Incorporated by reference to King s Amendment No. 1 to Quarterly Report on Form 10-Q filed February 15, 2006.

(16) Incorporated by reference to King s Amendment No. 2 to Current Report on Form 8-K/ A filed February 15, 2006.

(17) Incorporated by reference to King s Current Report on Form 8-K filed December 8, 2005.

(18) Incorporated by reference to King s definitive proxy statement, filed April 28, 2005, related to the 2005 annual meeting of shareholders.

(19) Incorporated by reference to King s Current Report on Form 8-K filed February 27, 2006.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
King Pharmaceuticals, Inc.:

We have completed integrated audits of King Pharmaceuticals, Inc. s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of King Pharmaceuticals, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in Management s Report on Internal Controls Over Financial Reporting as of December 31, 2005 appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for

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external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Raleigh, North Carolina
February 28, 2006, except for
the fifteenth paragraph
of Note 19 for which
the date is March 2, 2006

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KING PHARMACEUTICALS, INC.
CONSOLIDATED BALANCE SHEETS
as of December 31, 2005 and 2004
(in thousands, except share data)

	2005	2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 30,014	$ 192,656
Investments in debt securities	494,663	149,430
Restricted cash	130,400	97,730
Marketable securities		16,498
Accounts receivable, net of allowance of $12,280 and $15,348	223,581	180,963
Inventories	228,063	274,412
Deferred income tax assets	81,777	153,979
Prepaid expenses and other current assets	59,291	61,395
Total current assets	1,247,789	1,127,063
Property, plant and equipment, net	302,474	280,731
Goodwill	121,152	121,152
Intangible assets, net	967,194	1,285,961
Marketable securities	18,502	
Other assets (includes restricted cash of $14,129 and $2,775)	77,099	16,318
Deferred income tax assets	231,032	92,931
Total assets	$ 2,965,242	$ 2,924,156
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 84,539	$ 92,920
Accrued expenses	519,620	596,010
Income taxes payable	22,301	
Current portion of long term debt	345,000	
Total current liabilities	971,460	688,930
Long-term debt		345,000
Other liabilities	20,360	41,436
Total liabilities	991,820	1,075,366
Commitments and contingencies (Note 19)		
Shareholders equity:		
Preferred stock, 15,000,000 shares authorized, no shares issued or outstanding		
Common stock, no par value, 300,000,000 shares authorized, 241,802,724 and 241,706,583 shares issued and outstanding	1,222,246	1,210,647
Unearned compensation	(8,764)	

Retained earnings	754,953	637,120
Accumulated other comprehensive income	4,987	1,023
Total shareholders equity	1,973,422	1,848,790
Total liabilities and shareholders equity	$ 2,965,242	$ 2,924,156

The accompanying notes are an integral part of the consolidated financial statements.

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KING PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF INCOME (LOSS)
for the years ended December 31, 2005, 2004 and 2003
(in thousands, except share data)

	2005	2004	2003
Revenues:			
Net sales	$ 1,694,753	$ 1,225,890	$ 1,424,424
Royalty revenue	78,128	78,474	68,365
Total revenues	1,772,881	1,304,364	1,492,789
Operating costs and expenses:			
Costs of revenues, exclusive of depreciation, amortization and impairments shown below	322,985	352,938	385,841
Selling, general and administrative, exclusive of co-promotion fees	409,451	409,775	292,084
Medicaid related charge		65,000	
Mylan transaction costs	3,898	9,062	
Co-promotion fees	223,134	111,604	198,498
Total selling, general and administrative	636,483	595,441	490,582
Research and development	74,015	67,939	44,078
Research and development in process upon acquisition	188,711	16,300	194,000
Total research and development	262,726	84,239	238,078
Depreciation and amortization	147,049	162,115	113,745
Intangible asset impairment	221,054	149,592	124,616
Merger, restructuring, and other nonrecurring charges	4,180	10,827	
Gain on sale of products	(1,675)	(9,524)	(12,025)
Total operating costs and expenses	1,592,802	1,345,628	1,340,837
Operating income (loss)	180,079	(41,264)	151,952
Other income (expense):			
Interest income	18,175	5,974	6,849
Interest expense	(11,931)	(12,588)	(13,396)
Valuation (charge) benefit convertible notes receivable		(2,887)	18,551
Loss on investment	(6,182)	(6,520)	
Other, net	(2,026)	(749)	(629)

Total other (expense) income	(1,964)	(16,770)	11,375
Income (loss) from continuing operations before income taxes	178,115	(58,034)	163,327
Income tax expense (benefit)	61,485	(7,412)	65,884
Income (loss) from continuing operations	116,630	(50,622)	97,443
Discontinued operations (Note 27):			
Income (loss) from discontinued operations, including loss on impairment	1,876	(172,750)	(8,771)
Income tax expense (benefit)	673	(63,084)	(3,282)
Total income (loss) from discontinued operations	1,203	(109,666)	(5,489)
Net income (loss)	$ 117,833	$ (160,288)	$ 91,954
Income per common share:			
Basic: Income (loss) from continuing operations	$ 0.48	$ (0.21)	$ 0.40
Income (loss) from discontinued operations	0.01	(0.45)	(0.02)
Net income (loss)	$ 0.49	$ (0.66)	$ 0.38
Diluted: Income (loss) from continuing operations	$ 0.48	$ (0.21)	$ 0.40
Income (loss) from discontinued operations	0.01	(0.45)	(0.02)
Net income (loss)	$ 0.49	$ (0.66)	$ 0.38

The accompanying notes are an integral part of the consolidated financial statements.

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KING PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
AND OTHER COMPREHENSIVE INCOME (LOSS)
for the years ended December 31, 2003, 2004 and 2005
(in thousands, except share data)

	Common Stock		Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
Balance, January 1, 2003,	240,624,751	$ 1,201,897	$	$ 705,454	$ 45	$ 1,907,396
Comprehensive income:						
Net income				91,954		91,954
Net unrealized gain on marketable securities, net of tax of $363					674	674
Foreign currency translation, net of tax of $212					394	394
Total comprehensive income						93,022
Stock option activity	566,101	4,073				4,073
Balance, December 31, 2003	241,190,852	1,205,970		797,408	1,113	