

ENDO PHARMACEUTICALS HOLDINGS INC

Form 10-Q

April 29, 2011

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

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

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2011.**

**OR**

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

**FOR THE TRANSITION PERIOD FROM            TO            .**

**Commission file number: 001-15989**

**ENDO PHARMACEUTICALS HOLDINGS INC.**

(Exact Name of Registrant as Specified in Its Charter)

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

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

**13-4022871**  
(I.R.S. Employer  
Identification Number)

**100 Endo Boulevard Chadds Ford, Pennsylvania**  
(Address of Principal Executive Offices)

**(610) 558-9800**  
(Registrant's Telephone Number, Including Area Code)

**19317**  
(Zip Code)

**Not applicable**

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common Stock, \$0.01 par value

Shares outstanding as of April 18, 2011: 116,546,527

**Table of Contents**

**ENDO PHARMACEUTICALS HOLDINGS INC.**

**INDEX**

	<b>Page</b>
<u>Forward-Looking Statements</u>	i
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements</u>	1
<u>Condensed Consolidated Balance Sheets (Unaudited) March 31, 2011 and December 31, 2010</u>	1
<u>Condensed Consolidated Statements of Operations (Unaudited) Three Months Ended March 31, 2011 and 2010</u>	2
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) Three Months Ended March 31, 2011 and 2010</u>	3
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	4
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	44
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	67
Item 4. <u>Controls and Procedures</u>	67
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	68
Item 1A. <u>Risk Factors</u>	68
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	68
Item 3. <u>Defaults Upon Senior Securities</u>	68
Item 4. <u>Removed and Reserved</u>	68
Item 5. <u>Other Information</u>	68
Item 6. <u>Exhibits</u>	68
<b><u>SIGNATURES</u></b>	<b>69</b>

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

Statements contained or incorporated by reference in this Quarterly Report on Form 10-Q contain information that includes or is based on forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements, including estimates of future revenues, future expenses, future net income and future net income per share, contained in the section titled Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission on February 28, 2011, are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed results of operations. Also, statements including words such as believes, expects, anticipates, intends, estimates, plan, will, may or similar expressions are forward-looking statements. We have based these forward-looking statements on our current expectations and projections about the growth of our business, our financial performance and the development of our industry. Because these statements reflect our current views concerning future events, these forward-looking statements involve risks and uncertainties. Investors should note that many factors, as more fully described under the caption Risk Factors in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010 and as otherwise enumerated herein or therein, could affect our future financial results and could cause our actual results to differ materially from those expressed in forward-looking statements contained in our Annual Report on Form 10-K. Important factors that could cause our actual results to differ materially from the expectations reflected in the forward-looking statements in our Annual Report on Form 10-K include those factors described herein under the caption Risk Factors and in documents incorporated by reference, including, among others:

our ability to successfully develop, commercialize and market new products;

timing and results of pre-clinical or clinical trials on new products;

our ability to obtain regulatory approval of any of our pipeline products;

the effect of healthcare reform on our business;

competition for the business of our branded and generic products, and in connection with our acquisition of rights to intellectual property assets;

our ability to sustain our sales and profitability on generic pharmaceutical products over time;

our ability to keep our manufacturing facilities in compliance with regulatory requirements;

market acceptance of our future products;

government regulation of the pharmaceutical industry;

our dependence on a small number of Branded Pharmaceuticals products;

our dependence on outside manufacturers for the manufacture of most of our Branded Pharmaceuticals products;

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

our dependence on third parties to supply raw materials and to provide services for certain core aspects of our business;

new regulatory action or lawsuits relating to our use of narcotics in most of our core products;

our exposure to product liability claims and product recalls and the possibility that we may not be able to adequately insure ourselves;

our ability to protect our proprietary technology;

the successful efforts of manufacturers of branded pharmaceuticals to use litigation and legislative and regulatory efforts to limit the use of generics and certain other products;

our ability to successfully implement our acquisition and in-licensing strategy;

regulatory or other limits on the availability of controlled substances that constitute the active ingredients of some of our products and products in development;

the availability of third-party reimbursement for our products;

the outcome of any pending or future litigation or claims by third parties or the government, and the performance of indemnitors with respect to claims for which we have the right to be indemnified;

our dependence on sales to a limited number of large pharmacy chains and wholesale drug distributors for a large portion of our total revenues;

significant litigation expenses to defend or assert patent infringement claims;

any interruption or failure by our suppliers, distributors and collaboration partners to meet their obligations pursuant to various agreements with us;

a determination by a regulatory agency that we are engaging or have engaged in inappropriate sales or marketing activities, including promoting the off-label use of our products;

**Table of Contents**

existing suppliers become unavailable or lose their regulatory status as an approved source, causing an inability to obtain required components, raw materials or products on a timely basis or at commercially reasonable prices;

the loss of branded product exclusivity periods and related intellectual property;

our ability to successfully execute our strategy;

disruption of our operations if our information systems fail or if we are unsuccessful in implementing necessary upgrades or new software;

our ability to maintain or expand our business if we are unable to retain or attract key personnel and continue to attract additional professional staff;

our ability to successfully integrate HealthTronics, Inc. (HealthTronics), Penwest Pharmaceuticals Co. (Penwest), and Generics International (US Parent), Inc. (Qualitest), and realize all anticipated benefits of our acquisitions;

HealthTronics' ability to establish or maintain relationships with physicians and hospitals; and

HealthTronics' ability to comply with special risks and requirements related to its medical products manufacturing business.

We do not undertake any obligation to update our forward-looking statements after the date of this Report for any reason, even if new information becomes available or other events occur in the future. You are advised, however, to consult any further disclosures we make on related subjects in our 10-Q, 10-K, and 8-K reports filed with the Securities and Exchange Commission (SEC). Also note that we provide the preceding cautionary discussion of the risks, uncertainties and possibly inaccurate assumptions relevant to our business. These are factors that, individually or in the aggregate, we think could cause our actual results to differ materially from expected and historical results. We note these factors for investors as permitted by Section 27A of the Securities Act and Section 21E of the Exchange Act. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the preceding to be a complete discussion of all potential risks or uncertainties.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****ENDO PHARMACEUTICALS HOLDINGS INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)****(In thousands, except share and per share data)**

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 565,162	\$ 466,214
Accounts receivable, net	549,281	547,807
Inventories, net	205,296	178,805
Prepaid expenses and other current assets	29,545	22,841
Income taxes receivable		3,143
Deferred income taxes	148,890	140,724
Total current assets	\$ 1,498,174	\$ 1,359,534
MARKETABLE SECURITIES	23,701	23,509
PROPERTY, PLANT AND EQUIPMENT, NET	213,452	215,295
GOODWILL	719,300	715,005
OTHER INTANGIBLES, NET	1,486,199	1,531,760
OTHER ASSETS	65,269	67,286
<b>TOTAL ASSETS</b>	<b>\$ 4,006,095</b>	<b>\$ 3,912,389</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 265,516	\$ 241,114
Accrued expenses	475,831	469,721
Current portion of long-term debt	27,525	24,993
Acquisition-related contingent consideration	12,682	
Income taxes payable	6,538	
Total current liabilities	\$ 788,092	\$ 735,828
DEFERRED INCOME TAXES	218,078	217,334
ACQUISITION-RELATED CONTINGENT CONSIDERATION	3,510	16,050
LONG-TERM DEBT, LESS CURRENT PORTION, NET	1,044,120	1,045,801
OTHER LIABILITIES	88,572	94,047
COMMITMENTS AND CONTINGENCIES (NOTE 12)		
<b>STOCKHOLDERS EQUITY:</b>		
Preferred Stock, \$0.01 par value; 40,000,000 shares authorized; none issued		
Common Stock, \$0.01 par value; 350,000,000 shares authorized; 137,319,044 and 136,309,917 shares issued; 116,568,422 and 116,057,895 shares outstanding at March 31, 2011 and December 31, 2010, respectively	1,373	1,363
Additional paid-in capital	883,261	860,882
Retained earnings	1,420,084	1,364,297
Accumulated other comprehensive loss	(1,011)	(1,161)
Treasury stock, 20,750,622 and 20,252,022 shares at March 31, 2011 and December 31, 2010, respectively	(501,342)	(483,790)

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Total Endo Pharmaceuticals Holdings Inc. stockholders' equity	\$ 1,802,365	1,741,591
Noncontrolling interests	61,358	61,738
Total stockholders' equity	\$ 1,863,723	1,803,329
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 4,006,095</b>	<b>\$ 3,912,389</b>

See Notes to Condensed Consolidated Financial Statements.



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

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>REVENUES:</b>		
Net pharmaceutical product sales	\$ 505,784	\$ 360,349
Device, service and other revenues	54,242	4,063
<b>TOTAL REVENUES</b>	<b>\$ 560,026</b>	<b>\$ 364,412</b>
<b>COSTS AND EXPENSES:</b>		
Cost of revenues	231,558	94,073
Selling, general and administrative	159,386	133,335
Research and development	42,130	29,168
Acquisition-related items	6,073	1,529
<b>OPERATING INCOME</b>	<b>\$ 120,879</b>	<b>\$ 106,307</b>
<b>INTEREST EXPENSE, NET</b>	<b>18,790</b>	<b>9,804</b>
<b>OTHER EXPENSE (INCOME), NET</b>	<b>348</b>	<b>(219)</b>
<b>INCOME BEFORE INCOME TAX</b>	<b>\$ 101,741</b>	<b>\$ 96,722</b>
<b>INCOME TAX</b>	<b>33,446</b>	<b>36,367</b>
<b>CONSOLIDATED NET INCOME</b>	<b>\$ 68,295</b>	<b>\$ 60,355</b>
Less: Net income attributable to noncontrolling interests	12,508	
<b>NET INCOME ATTRIBUTABLE TO ENDO PHARMACEUTICALS HOLDINGS INC.</b>	<b>\$ 55,787</b>	<b>\$ 60,355</b>
<b>NET INCOME PER SHARE:</b>		
Basic	\$ 0.48	\$ 0.51
Diluted	\$ 0.46	\$ 0.51
<b>WEIGHTED AVERAGE SHARES:</b>		
Basic	116,354	117,347
Diluted	120,761	118,031

See Notes to Condensed Consolidated Financial Statements.

**Table of Contents****ENDO PHARMACEUTICALS HOLDINGS INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)****(In thousands)**

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>OPERATING ACTIVITIES:</b>		
Consolidated net income	\$ 68,295	\$ 60,355
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	47,741	21,521
Stock-based compensation	7,416	3,791
Amortization of debt issuance costs and premium / discount	5,997	5,657
Selling, general and administrative expenses paid in shares of common stock	55	55
Deferred income taxes	(768)	5,475
Loss on disposal of property, plant and equipment	114	17
Change in fair value of acquisition-related contingent consideration	(685)	890
Loss on auction-rate securities rights		1,910
Unrealized gain on trading securities		(1,706)
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable	(1,576)	(823)
Inventories	(26,473)	(2,157)
Prepaid and other assets	(4,871)	(871)
Accounts payable	28,095	(4,702)
Accrued expenses	4,639	3,104
Other liabilities	(6,602)	(1,091)
Income taxes payable/receivable	9,681	17,980
<b>Net cash provided by operating activities</b>	<b>131,058</b>	<b>109,405</b>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment, net	(12,561)	(3,165)
Proceeds from sales of available-for-sale securities		32,475
Acquisitions, net of cash acquired	(1,232)	
Other investments	522	
<b>Net cash (used in) provided by investing activities</b>	<b>(13,271)</b>	<b>29,310</b>
<b>FINANCING ACTIVITIES:</b>		
Capital lease obligations repayments		(95)
Tax benefits of stock awards	3,381	368
Principal payments on debt, net of proceeds	(4,197)	
Exercise of Endo Pharmaceuticals Holdings Inc. stock options	12,417	1,530
Purchase of common stock	(17,552)	(29,008)
Distributions to noncontrolling interests	(12,627)	
Buy-out of noncontrolling interests, net of contributions	(261)	
<b>Net cash used in financing activities</b>	<b>(18,839)</b>	<b>(27,205)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>98,948</b>	<b>111,510</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>466,214</b>	<b>708,462</b>

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 565,162	\$ 819,972
SUPPLEMENTAL INFORMATION:		
Cash paid for interest	\$ 2,865	\$ 2,843
Cash paid for income taxes	\$ 19,854	\$ 13,572
SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Purchases of property, plant and equipment financed by capital leases	\$ 62	\$ 162
Accrual for purchases of property, plant and equipment	\$ 2,855	\$ 2,291

See Notes to Condensed Consolidated Financial Statements.

**Table of Contents**

**ENDO PHARMACEUTICALS HOLDINGS INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**FOR THE THREE MONTHS ENDED MARCH 31, 2011**

**NOTE 1. BASIS OF PRESENTATION**

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying Condensed Consolidated Financial Statements of Endo Pharmaceuticals Holdings Inc. (the Company or we, our, us, or Endo) and its subsidiaries, which are unaudited, include all normal and recurring adjustments considered necessary to present fairly the Company's financial position as of March 31, 2011 and the results of our operations and our cash flows for the periods presented. Operating results for the three-month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

In November 2010, the Company acquired Qualitest, a United States based privately-held generics company. In September 2010, the Company acquired its partner on Opana® ER, Penwest, a drug delivery company focused on applying its drug delivery technologies and drug formulation expertise to the formulation of its collaborators' product candidates under licensing collaborations. In July 2010, the Company acquired HealthTronics, a provider of healthcare services and manufacturer of medical devices, primarily for the urology community. The condensed consolidated results of operations presented herein reflect the operating results of HealthTronics, Penwest, and Qualitest from January 1, 2011. Additionally, all of the assets acquired and liabilities assumed in connection with the Qualitest, Penwest, and HealthTronics acquisitions are recorded at their respective fair values and are included in the accompanying Condensed Consolidated Financial Statements as of March 31, 2011.

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2010, the Financial Accounting Standards Board (FASB) issued additional Accounting Standards Update (ASU) 2010-29 on interim and annual disclosure of pro forma financial information related to business combinations. The new guidance clarifies the acquisition date that should be used for reporting the pro forma financial information in which comparative financial statements are presented. It is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010.

In December 2010, the FASB issued additional ASU 2010-28 on accounting for goodwill. The guidance clarifies the impairment test for reporting units with zero or negative carrying amounts. The guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2011. The adoption is not expected to have a material impact on the company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-27 on accounting for the annual fee imposed by the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act. The new guidance specifies that the liability for the fee should be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense. It is effective on a prospective basis for calendar years beginning after December 31, 2010. We expect this fee will be approximately \$11 million in 2011, which will be charged as an operating expense ratably throughout 2011.

**NOTE 3. FAIR VALUE MEASUREMENTS**

The financial instruments recorded in our Condensed Consolidated Balance Sheets include cash and cash equivalents, accounts receivable, marketable securities, auction-rate securities rights, equity and cost method investments, accounts payable, acquisition-related contingent consideration, and our debt obligations. Included in cash and cash equivalents are money market funds representing a type of mutual fund required by law to invest in low-risk securities (for example, U.S. government bonds, U.S. Treasury Bills and commercial paper). Money market funds are structured to maintain the fund's net asset value at \$1 per unit, which assists in ensuring adequate liquidity upon demand by the holder. Money market funds pay dividends that generally reflect short-term interest rates. Thus, only the dividend yield fluctuates. Due to their short-term maturity, the carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate their fair values.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

The following table presents the carrying amounts and estimated fair values of our other financial instruments as of March 31, 2011 and December 31, 2010 (in thousands):

	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term assets:				
Auction-rate securities	\$ 17,409	\$ 17,409	\$ 17,332	\$ 17,332
Equity securities	6,292	6,292	6,177	6,177

**Table of Contents**

	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Equity and cost method investments	33,712	n/a	34,677	n/a
	\$ 57,413		\$ 58,186	
<b>Current liabilities:</b>				
Acquisition-related contingent consideration short-term	(12,682)	(12,682)		
Current portion of long-term debt	(27,525)	(27,525)	(24,993)	(24,993)
<b>Long-term liabilities:</b>				
Acquisition-related contingent consideration long-term	(3,510)	(3,510)	(16,050)	(16,050)
Term Loan Due 2015, less current portion, net	(370,000)	(370,000)	(377,500)	(380,038)
7.00% Senior Notes due 2020, net	(386,885)	(417,668)	(386,716)	(403,308)
1.75% Convertible Senior Subordinated Notes due 2015, net	(283,801)	(321,717)	(278,922)	(324,257)
Minimum Voltaren® Gel royalties due to Novartis	(32,371)	(32,371)	(38,922)	(38,922)
Other long-term debt, less current portion	(3,435)	(3,435)	(2,663)	(2,663)
	\$ (1,120,209)	\$ (1,188,908)	\$ (1,125,766)	\$ (1,190,231)

Equity securities consist of publicly traded common stock, the value of which is based on a quoted market price. These securities are not held to support current operations and are therefore classified as non-current assets. The acquisition-related contingent consideration, which is required to be measured at fair value on a recurring basis, consists primarily of amounts payable to the former Indevus Pharmaceuticals Inc. (Indevus) shareholders under contingent cash consideration agreements relating to the development of Avedit™ and contingent cash consideration related to the November 2010 acquisition of Qualitest. The fair value of our acquisition-related contingent consideration is determined using an income approach (present value technique), which is discussed in more detail below. The fair values of our Term Loan Facility due 2015 and our 7.00% Senior Notes due 2020 were estimated using a discounted cash flow model based on the contractual repayment terms of the respective instruments and discount rates that reflect current market conditions. The fair value of our 1.75% Convertible Senior Subordinated Notes is based on an income approach known as the binomial lattice model which incorporated certain inputs and assumptions, including scheduled coupon and principal payments, the conversion feature inherent in the Convertible Notes, the put feature inherent in the Convertible Notes, and stock price volatility assumptions of 33% at March 31, 2011 and December 31, 2010 that were based on historic volatility of the Company's common stock and other factors.

The minimum Voltaren® Gel royalty due to Novartis AG was recorded at fair value at inception during 2008 using an income approach (present value technique) and is being accreted up to the maximum potential future payment of \$60.0 million. The Company is not aware of any events or circumstances that would have a significant effect on the fair value of this Novartis AG liability. We believe the carrying amount of this minimum royalty guarantee at March 31, 2011 and December 31, 2010 represents a reasonable approximation of the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date. Accordingly, the carrying value approximates fair value as of March 31, 2011 and December 31, 2010.

The fair value of equity method and cost method investments is not readily available nor have we estimated the fair value of these investments and disclosure is not required. The Company is not aware of any identified events or changes in circumstances that would have a significant adverse effect on the carrying value of our \$23.1 million of cost method investments at March 31, 2011.

As of March 31, 2011, the Company held certain assets and liabilities that are required to be measured at fair value on a recurring basis, including money market funds, available-for-sale securities, and acquisition-related contingent consideration. Fair value guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1 Quoted prices in active markets for identical assets or liabilities.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**Table of Contents**

The Company's financial assets and liabilities measured at fair value on a recurring basis at March 31, 2011 and December 31, 2010, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>As of March 31, 2011:</b>				
<b>Assets:</b>				
Money market funds	\$ 131,196	\$	\$	\$ 131,196
Auction-rate securities			17,409	17,409
Equity securities	6,292			6,292
Total	\$ 137,488	\$	\$ 17,409	\$ 154,897
<b>Liabilities:</b>				
Acquisition-related contingent consideration short-term			(12,682)	(12,682)
Acquisition-related contingent consideration long-term			(3,510)	(3,510)
Total	\$	\$	\$ (16,192)	\$ (16,192)
<b>As of December 31, 2010</b>				
<b>Assets:</b>				
Money market funds	149,318			149,318
Auction-rate securities			17,332	17,332
Equity securities	6,177			6,177
Total	\$ 155,495	\$	\$ 17,332	\$ 172,827
<b>Liabilities:</b>				
Acquisition-related contingent consideration long-term			(16,050)	(16,050)
Total	\$	\$	\$ (16,050)	\$ (16,050)

**Overview of Auction-Rate Securities**

Auction-rate securities are long-term variable rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (e.g., every seven, twenty-eight, or thirty-five days; every six months; etc.). In an active market, auction-rate securities are bought and sold at each reset date through a competitive bidding process, often referred to as a "Dutch auction". Auctions are successful when the supply and demand of securities are in balance. Financial institutions brokering the auctions would also participate in the auctions to balance the supply and demand. Beginning in the second half of 2007, auctions began to fail for specific securities and in mid-February 2008 auction failures became common, prompting market participants, including financial institutions, to cease or limit their exposure to the auction-rate market. Given the current negative liquidity conditions in the global credit markets, the auction-rate securities market has become inactive. Consequently, our auction-rate securities are currently illiquid through the normal auction process. As a result of the inactivity in the market, quoted market prices and other observable data are not available or their utility is limited.



## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

At March 31, 2011, the Company determined that the market for its auction-rate securities was still inactive. That determination was made considering that there are very few observable transactions for the auction-rate securities or similar securities, the prices for transactions that have occurred are not current, and the observable prices for those transactions to the extent they exist vary substantially either over time or among market makers, thus reducing the potential usefulness of those observations. In addition, the current lack of liquidity prevents the Company from comparing our securities directly to securities with quoted market prices.

Our auction-rate securities consist of municipal bonds with an auction reset feature, the underlying assets of which are student loans that are backed substantially by the federal government and have underlying credit ratings of AAA as of March 31, 2011 and December 31, 2010. Further, the issuers have been making interest payments promptly.

### ***Overview of Auction-Rate Securities Rights***

In October 2008, UBS AG (UBS) made an offer (the UBS Offer) to the Company and other clients of UBS Securities LLC and UBS Financial Services Inc. (collectively, the UBS Entities), pursuant to which the Company received auction-rate securities rights (the Rights) to sell to UBS all auction-rate securities held by the Company as of February 13, 2008 in a UBS account (the Eligible Auction-Rate Securities). The Rights permitted the Company to require UBS to purchase the Eligible Auction-Rate Securities for a price equal to par value plus any accrued but unpaid dividends or interest beginning on June 30, 2010 and ending on July 2, 2012.

On November 10, 2008, the Company accepted the UBS Offer, awarding the UBS Entities the sole discretion and right to sell or otherwise dispose of, and/or enter orders in the auction process with respect to the Eligible Auction-Rate Securities on the Company's behalf until the Expiration Date, without prior notification, so long as the Company receives a payment of par value plus any accrued but unpaid dividends or interest upon any sale or disposition.

## **Table of Contents**

### ***Subsequent Accounting for Auction-Rate Securities and Auction-Rate Securities Rights***

Concurrent with the acceptance of the UBS offer, the Company made a one-time election to re-classify the Eligible Auction-Rate Securities from an available-for-sale security to a trading security. Subsequent changes to the fair value of these trading securities resulted in \$1.7 million of income during the three months ended March 31, 2010 and were recorded in Other expense (income), net in the Condensed Consolidated Statements of Operations.

As a result of our fair value election for the Rights, the fair value of the Rights was re-measured each reporting period with the corresponding changes in fair value reported in earnings. In June 2010, the Rights were exercised. Accordingly, the related asset was written off with a corresponding charge to earnings of \$15.7 million for the year ended December 31, 2010.

At March 31, 2011 and December 31, 2010, the fair value of the Rights was zero. The decrease in fair value from December 31, 2009 to March 31, 2010 of \$1.9 million was recognized as a charge to earnings and included in Other expense (income), net in the Condensed Consolidated Statements of Operations.

### ***Valuation of the Auction-Rate Securities***

The Company determined that an income approach (present value technique) that maximizes the use of observable market inputs is the preferred approach to measuring the fair value of our securities. Specifically, the Company used the discount rate adjustment technique to determine an indication of fair value.

To calculate a price for our auction-rate securities, the Company calculates duration to maturity, coupon rates, market required rates of return (discount rate) and a discount for lack of liquidity in the following manner:

The Company identifies the duration to maturity of the auction-rate securities as the time at which principal is available to the investor. This can occur because the auction-rate security is paying a coupon that is above the required rate of return, and the Company treats the security as being called. It can also occur because the market has returned to normal and the Company treats the auctions as having recommenced. Lastly, and most frequently, the Company treats the principal as being returned as prepayment occurs and at the maturity of the security. The initial life used for each remaining security, representing time to maturity, was eight years as of March 31, 2011 and December 31, 2010.

The Company calculates coupon rates based on estimated relationships between the maximum coupon rate (the coupon rate in event of a failure) and market interest rates. The representative coupon rate was 5.23% on March 31, 2011 and 5.10% at December 31, 2010. The Company calculates appropriate discount rates for securities that include base interest rates, index spreads over the base rate, and security-specific spreads. These spreads include the possibility of changes in credit risk over time. The spread over the base rate applied to our securities was 202 basis points at March 31, 2011 and 218 basis points at December 31, 2010.

The Company believes that a market participant would require an adjustment to the required rate of return to adjust for the lack of liquidity. We do not believe it is unreasonable to assume a 150 basis points adjustment to the required rate of return and a term of either three, four or five years to adjust for this lack of liquidity. The increase in the required rate of return decreases the prices of the securities. However, the assumption of a three, four or five-year term shortens the times to maturity and increases the prices of the securities. The Company has evaluated the impact of applying each term and the reasonableness of the range indicated by the results. The Company chose to use a four-year term to adjust for the lack of liquidity as we believe it is the point within the range that is most representative of fair value. The Company's conclusion is based in part on the fact that the fair values indicated by the results are reasonable in relation to each other given the nature of the securities and current market conditions.

At March 31, 2011, the fair value of our auction-rate securities, as determined by applying the above described discount rate adjustment technique, was approximately \$17.4 million, representing a 7%, or \$1.4 million discount from their original purchase price or par value. This compares to approximately \$17.3 million, representing an 8%, or \$1.5 million discount from their original purchase price or par value at December 31, 2010. We believe we have appropriately reflected our best estimate of the assumptions that market participants would use in pricing the assets in a current transaction to sell the asset at the measurement date. Accordingly, the carrying value of our auction-rate securities at March 31, 2011 and December 31, 2010 were reduced by approximately \$1.4 million and \$1.5 million, respectively. These adjustments appropriately reflect the changes in fair value, which the Company attributes to liquidity issues rather than credit issues.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

The portion of this decline in fair value related to the Eligible Auction-Rate Securities was recorded in earnings as an other-than-temporary impairment charge or as changes in the fair value of trading securities. The Company has assessed the portion of the decline in fair value not associated with the Eligible Auction-Rate Securities to be temporary due to the financial condition and near-term prospects of the underlying issuers, our intent and ability to retain our investment in the issuers for a period of time sufficient to allow for any anticipated recovery in market value and based on the extent to which fair value is less than par. Accordingly, we recorded a \$0.1 million gain and a \$0.4 million loss in Stockholders' equity in Accumulated other comprehensive loss as of March 31, 2011 and December 31, 2010, respectively. Securities not subject to the UBS Offer are analyzed each reporting period for other-than-

## **Table of Contents**

temporary impairment factors. Any future fluctuation in fair value related to these instruments that the Company judges to be temporary, including any recoveries of previous write-downs, would be recorded to other comprehensive income. If the Company determines that any future valuation adjustment was other-than-temporary, it would record a charge to earnings as appropriate. However, there can be no assurance that our current belief that the securities not subject to the UBS Offer will recover their value will not change.

### ***Valuation of the Auction-Rate Securities Rights***

Until the Rights were exercised and all UBS securities were sold on June 30, 2010, the Company valued the Rights using an income approach (present value technique) that maximized the use of observable market inputs. Specifically, the Company used the discount rate adjustment technique to determine an indication of fair value.

Upon the exercise of the Rights and sale of all remaining UBS securities on June 30, 2010, the fair value of the Rights was adjusted to zero.

### ***Overview of Acquisition-Related Contingent Consideration***

As of March 31, 2011 and December 31, 2010, the fair value of the contingent consideration is \$16.2 million and \$7.1 million, respectively. The material components of this obligation are discussed below.

#### ***Indevus***

On February 23, 2009 (the Indevus Acquisition Date), the Company completed its initial tender offer for all outstanding shares of common stock of Indevus. Through purchases in subsequent offer periods, the exercise of a top-up option and a subsequent merger, the Company completed its acquisition of Indevus on March 23, 2009, at which time Indevus became a wholly-owned subsidiary of the Company. The Indevus Shares were purchased at a price of \$4.50 per Indevus Share, net to the seller in cash, plus contractual rights to receive up to an additional \$3.00 per Indevus Share in contingent cash consideration payments related to potential future regulatory and commercial milestones related to Aveed<sup>TM</sup> (the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement) and the octreotide NDA for the treatment of acromegaly (the Octreotide Contingent Cash Consideration Agreement). Additionally, upon the acquisition of Indevus, the Company assumed a pre-existing contingent consideration obligation relating to Indevus acquisition of Valera Pharmaceuticals, Inc. (the Valera Contingent Consideration Agreement), which could entitle former Valera shareholders to receive consideration from the Company upon U.S. Food and Drug Administration (FDA) approval of the octreotide implant for the treatment for acromegaly. The key terms of these three contingent consideration agreements (collectively, the Indevus Contingent Consideration Agreements) are as follows:

***Aveed<sup>TM</sup> Contingent Consideration*** In the event that the Company receives an approval letter from the FDA with respect to the Aveed<sup>TM</sup> NDA on or before the third anniversary of the time at which we purchased the Indevus shares in our initial tender offer (the Offer), then the Company will (1) pay an additional \$2.00 per Indevus share to the former stockholders of Indevus if such approval letter grants the right to market and sell Aveed<sup>TM</sup> immediately and provides labeling for Aveed<sup>TM</sup> that does not contain a boxed warning (Aveed<sup>TM</sup> With Label) or alternatively, (2) pay an additional \$1.00 per Indevus share, if such approval letter grants the right to market and sell Aveed<sup>TM</sup> immediately and provides labeling for Aveed<sup>TM</sup> that contains a boxed warning (Aveed<sup>TM</sup> Without Label). In the event that either an Aveed<sup>TM</sup> With Label approval or an Aveed<sup>TM</sup> Without Label approval has not been obtained prior to the third anniversary of the closing of the Offer, then the Company will not pay, and the former Indevus stockholders will not receive, any payments under the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement.

Further, in the event that the Aveed<sup>TM</sup> Without Label approval is received and subsequently, Endo and its subsidiaries publicly report audited financial statements which reflect cumulative net sales of Aveed<sup>TM</sup> of at least \$125.0 million for four consecutive calendar quarters on or prior to the fifth anniversary of the date of the first commercial sale of Aveed<sup>TM</sup> (Aveed<sup>TM</sup> Net Sales Event), then the Company will, subject to the terms described below, pay an additional \$1.00 per Indevus share to the former stockholders of Indevus. In the event that the Aveed<sup>TM</sup> Net Sales Event does not occur prior to the fifth anniversary of the date of the first commercial sale of Aveed<sup>TM</sup> then the Company will not pay, and former Indevus stockholders will not receive, any additional amounts under the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

*Octreotide Contingent Consideration* In the event that an approval letter from the FDA is received with respect to an octreotide NDA (such approval letter, the Octreotide Approval) on or before the fourth anniversary of the closing of the Offer, then the Company will pay an additional \$1.00 per Indevus share to the former stockholders of Indevus (such payment, the Octreotide Contingent Cash Consideration Payment). In the event that an Octreotide Approval has not been obtained prior to the fourth anniversary of the closing of the Offer, then the Company will not pay, and the former Indevus stockholders shall not receive, the Octreotide Contingent Cash Consideration Payment.

*Valera Contingent Consideration* In connection with our acquisition of Indevus, the Company assumed Indevus pre-existing contingent obligations under the Valera Contingent Consideration Agreement, which was consummated on April 18, 2007. Prior to our acquisition of Indevus, the Valera Contingent Consideration Agreement entitled former Valera

**Table of Contents**

shareholders to receive additional Indevus shares based on an agreed upon conversion factor if FDA approval of the octreotide implant for the treatment of acromegaly was achieved on or before April 18, 2012 (Valera Triggering Event). Concurrently with Endo's acquisition of Indevus, each Valera shareholder's right to receive additional Indevus shares was converted into the right to receive, upon the occurrence of the Valera Triggering Event, the following amounts for each Indevus share that such former Valera shareholder would have received upon the occurrence of the Valera Triggering Event, if not for Endo's acquisition of Indevus: (1) \$4.50 plus (2) contractual rights to receive up to an additional \$3.00 in contingent cash consideration payments under the Aveed™ Contingent Cash Consideration Agreement and the Octreotide Contingent Cash Consideration Agreement.

*Qualitest*

On November 30, 2010 (the Qualitest Acquisition Date), Endo acquired Qualitest, who was party to an asset purchase agreement with Teva Pharmaceutical Industries Ltd (Teva) (the Teva Agreement). Pursuant to this agreement, Qualitest purchased certain pipeline generic products from Teva and could be obligated to pay consideration to Teva upon the achievement of certain future regulatory milestones (the Teva Contingent Consideration).

***Valuation of the Acquisition-Related Contingent Consideration****Indevus*

The Indevus Contingent Consideration Agreements were measured and recognized at fair value upon our acquisition of Indevus and are required to be re-measured on a recurring basis, with changes to fair value recorded in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations. The fair values were determined using a probability-weighted discounted cash flow model, or income approach. This fair value measurement technique is based on significant inputs not observable in the market and thus represents a Level 3 measurement within the fair value hierarchy. The valuation of each Indevus Contingent Consideration Agreement is described in further detail below:

*Aveed™ Contingent Consideration* The range of the undiscounted amounts the Company could pay under the Aveed™ Contingent Cash Consideration Agreement is between zero and approximately \$175.0 million. Under this agreement, there are three scenarios that could potentially lead to amounts being paid to the former stockholders of Indevus. These scenarios are (1) obtaining an Aveed™ With Label approval, (2) obtaining an Aveed™ Without Label approval and (3) achieving the \$125.0 million sales milestone on or prior to the fifth anniversary of the date of the first commercial sale of Aveed™ should the Aveed™ Without Label approval be obtained. The fourth scenario is Aveed™ not receiving approval within three years of the closing of the Offer, which would result in no payment to the former stockholders of Indevus. Each scenario was assigned a probability based on the current regulatory status of Aveed™. The resultant probability-weighted cash flows were then discounted using a discount rate of U.S. Prime plus 300 basis points, which the Company believes is appropriate and is representative of a market participant assumption. Using this valuation technique, the fair value of the contractual obligation to pay the Aveed™ Contingent Consideration was determined to be \$133.1 million on the Indevus Acquisition Date, \$7.2 million at March 31, 2011, and \$7.1 million at December 31, 2010.

*Octreotide Contingent Consideration* The range of the undiscounted amounts the Company could pay under the Octreotide Contingent Cash Consideration Agreement is between zero and approximately \$91.0 million. Under this agreement, the two scenarios that require consideration are (1) Octreotide Approval on or before the fourth anniversary of the closing of the Offer or (2) no Octreotide Approval on or before the fourth anniversary of the closing of the Offer. Each scenario was assigned a probability based on the current development stage of octreotide. The resultant probability-weighted cash flows were then discounted using a discount rate of U.S. Prime plus 300 basis points, which the Company believes is appropriate and is representative of a market participant assumption. Using this valuation technique, the fair value of the contractual obligation to pay the Octreotide Contingent Consideration was determined to be \$39.8 million on the Indevus Acquisition Date and zero at both March 31, 2011 and December 31, 2010.

*Valera Contingent Consideration* The range of the undiscounted amounts the Company could pay under the Valera Contingent Cash Consideration Agreement is between zero and approximately \$33.0 million. The fair value of the Valera Contingent Consideration is estimated using the same assumptions used for the Aveed™ Contingent Cash Consideration Agreement and Octreotide Contingent Cash Consideration Agreement, except that the probabilities associated with the Valera Contingent Consideration take into account

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

the probability of obtaining the Octreotide Approval on or before the fourth anniversary of the closing of the Offer. This is due to the fact that the Valera Contingent Consideration will not be paid unless octreotide for the treatment of acromegaly is approved prior to April 18, 2012. Using this valuation technique, the fair value of the contractual obligation to pay the Valera Contingent Consideration was determined to be \$13.7 million on the Indevus Acquisition Date and zero at both March 31, 2011 and December 31, 2010.

These amounts reflect management's current assessment of the probability that it will not be obligated to make contingent consideration payments based on the anticipated timeline for the NDA filing and FDA approval of octreotide for the treatment of acromegaly. Future changes in any of our assumptions could result in further volatility to the estimated fair value of the acquisition-related contingent consideration. Such additional changes to fair value could materially impact our results of operations in future periods.

**Table of Contents**

At March 31, 2011, the aggregate fair value of the three Indevus Contingent Consideration Agreements increased from \$7.1 million at December 31, 2010 to \$7.2 million at March 31, 2011. This increase primarily reflects changes of our present value assumptions associated with our valuation model. The increase in the liability was recorded as a loss and is included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations.

*Qualitest*

The range of the undiscounted amounts the Company could pay under the Teva Agreement is between zero and \$12.5 million. The Company is accounting for the Teva Contingent Consideration in the same manner as if it had entered into that arrangement with respect to its acquisition of Qualitest. Accordingly, the fair value was estimated based on a probability-weighted discounted cash flow model, or income approach. The resultant probability-weighted cash flows were then discounted using a discount rate of U.S. Prime plus 300 basis points. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement within the fair value hierarchy. Using this valuation technique, the fair value of the contractual obligation to pay the Teva Contingent Consideration was determined to be \$9.0 million on the Qualitest Acquisition Date and December 31, 2010 and was determined to be \$8.2 million at March 31, 2011.

The decrease from December 31, 2010 to March 31, 2011 primarily reflects changes of our present value assumptions associated with our valuation model. The decrease in the liability was recorded as a gain and is included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations.

The following table presents changes to the Company's financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2011 (in thousands):

	<b>Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction-rate Securities</b>
<b>Assets:</b>	
Balance at January 1, 2011	\$ 17,332
Securities sold or redeemed	
Transfers in and/or (out) of Level 3	
Changes in fair value recorded in earnings	
Unrealized gains included in other comprehensive income	77
<b>Balance at March 31, 2011</b>	<b>\$ 17,409</b>

	<b>Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Acquisition-related Contingent Consideration</b>
<b>Liabilities:</b>	
Balance at January 1, 2011	\$ (16,050)
Amounts acquired or issued	(827)
Transfers in and/or (out) of Level 3	
Changes in fair value recorded in earnings	685
<b>Balance at March 31, 2011</b>	<b>\$ (16,192)</b>



**Table of Contents**

The following table presents changes to the Company's financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2010 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Auction-rate Securities	Auction-rate Securities Rights	Total
<b>Assets:</b>			
Balance at January 1, 2010	\$ 207,334	\$ 15,659	\$ 222,993
Securities sold or redeemed	(7,200)		(7,200)
Securities purchased or acquired			
Transfers in and/or (out) of Level 3(1)	(15,000)		(15,000)
Changes in fair value recorded in earnings	1,706	(1,910)	(204)
Unrealized gain included in other comprehensive loss	11		11
Balance at March 31, 2010	\$ 186,851	\$ 13,749	\$ 200,600

- (1) Transfers out of Level 3 represent auction-rate securities classified as trading securities that were sold subsequent to March 31, 2010 at amounts equal to our original par value investment. Consequently, these trading securities were transferred from Level 3 to Level 1 within the fair value hierarchy and were classified as current marketable securities at March 31, 2010.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Acquisition-related Contingent Consideration	
<b>Liabilities:</b>		
Balance at January 1, 2010	\$	(58,470)
Amounts acquired or issued		
Transfers in and/or (out) of Level 3		
Changes in fair value recorded in earnings		(890)
Balance at March 31, 2010	\$	(59,360)

At March 31, 2011 and December 31, 2010, the respective fair values of the Company's trading securities were zero. The following is a summary of available-for-sale securities held by the Company as of March 31, 2011 and December 31, 2010 (in thousands):

	Amortized Cost	Available-for-sale		Fair Value
		Gross Unrealized Gains	Gross Unrealized (Losses)	
<b>March 31, 2011:</b>				
Money market funds	\$ 131,196	\$	\$	\$ 131,196
<i>Total included in cash and cash equivalents</i>	\$ 131,196	\$	\$	\$ 131,196
Auction-rate securities	18,800		(1,391)	17,409
Equity securities	5,564	728		6,292

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

<i>Long-term available-for-sale securities</i>	\$ 24,364	\$ 728	\$ (1,391)	\$ 23,701
<i>Total available-for-sale securities</i>	\$ 155,560	\$ 728	\$ (1,391)	\$ 154,897

**December 31, 2010:**

Money market funds	\$ 149,318	\$	\$	\$ 149,318
--------------------	------------	----	----	------------

<i>Total included in cash and cash equivalents</i>	\$ 149,318	\$	\$	\$ 149,318
--	------------	----	----	------------

Auction-rate securities	18,800		(1,468)	17,332
-------------------------	--------	--	---------	--------

Equity securities	5,564	613		6,177
-------------------	-------	-----	--	-------

<i>Long-term available-for-sale securities</i>	\$ 24,364	\$ 613	\$ (1,468)	\$ 23,509
--	-----------	--------	------------	-----------

<i>Total available-for-sale securities</i>	\$ 173,682	\$ 613	\$ (1,468)	\$ 172,827
--	------------	--------	------------	------------

**Table of Contents**

We did not sell any of our remaining auction-rate securities during the three months ended March 31, 2011. During the three-month period ended March 31, 2010, we sold \$32.5 million of auction-rate securities at par value. There were no realized holding gains and losses resulting from the sales of our auction rate securities and variable rate demand obligations during the period ended March 31, 2011 and 2010. The cost of securities sold is based on the specific identification method.

The underlying assets of our auction-rate securities are student loans. Student loans are insured by the Federal Family Education Loan Program, or FFELP.

As of March 31, 2011, the yields on our long-term auction-rate securities ranged from 0.54% to 0.60%. These yields represent the predetermined maximum reset rates that occur upon auction failures according to the specific terms within each security's prospectus. As of March 31, 2011, the weighted average yield for our long-term auction-rate securities was 0.57%. Total interest recognized on our auction-rate securities during the quarters ended March 31, 2011 and 2010 was less than \$0.1 million and \$0.3 million, respectively. The issuers have been making interest payments promptly.

The amortized cost and estimated fair value of available-for-sale debt and equity securities by contractual maturities are shown below (in thousands). Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2011		December 31, 2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available-for-sale debt securities:				
Due in less than 1 year	\$	\$	\$	\$
Due in 1 to 5 years				
Due in 5 to 10 years				
Due after 10 years	18,800	17,409	18,800	17,332
Equity securities	5,564	6,292	5,564	6,177
<b>Total</b>	<b>\$ 24,364</b>	<b>\$ 23,701</b>	<b>\$ 24,364</b>	<b>\$ 23,509</b>

**NOTE 4. INVENTORIES**

Inventories are comprised of the following at March 31, 2011 and December 31, 2010, respectively (in thousands):

	March 31, 2011	December 31, 2010
Raw materials	\$ 64,583	\$ 45,957
Work-in-process	49,372	34,208
Finished goods	91,341	98,640
<b>Total</b>	<b>\$ 205,296</b>	<b>\$ 178,805</b>

Inventory amounts in the table above are shown net of obsolescence. Our reserve for obsolescence is not material to the Condensed Consolidated Balance Sheets for any of the periods presented and therefore has not been separately disclosed.

**NOTE 5. ACQUISITIONS*****Qualitest***

On November 30, 2010 (the Qualitest Acquisition Date), Endo completed its acquisition of all of the issued and outstanding capital stock of Generics International (US Parent), Inc. (Qualitest) from an affiliate of Apax Partners, L.P. for approximately \$769.4 million. In addition, Endo

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

paid \$406.8 million to retire Qualitest's outstanding debt and related interest rate swap on November 30, 2010. In connection with the Qualitest acquisition, \$108 million of the purchase price was placed into escrow. One of the escrow amounts is for \$8 million and will be used to fund any working capital adjustments, as defined in the Qualitest Stock Purchase Agreement. We expect this escrow to be settled in 2011. There is also a \$100 million escrow account that will be used to fund all claims arising out of or related to the Qualitest acquisition.

In connection with the \$100 million escrow account, to the extent that we are able to realize tax benefits for costs that are funded by the escrow account, we will be required to share these tax benefits with Apax.

Qualitest is a manufacturer and distributor of generic drugs and over-the-counter pharmaceuticals throughout the United States. Qualitest's product portfolio is comprised of 175 product families in various forms including tablets, capsules, creams, ointments, suppositories, and liquids. This acquisition will enable us to gain critical mass in our generics business while strengthening our pain portfolio through a larger breadth of product offerings.

**Table of Contents**

The operating results of Qualitest from November 30, 2010 are included in the accompanying Condensed Consolidated Statements of Operations. The Consolidated Balance Sheet as of March 31, 2011 and December 31, 2010 reflect the acquisition of Qualitest, effective November 30, 2010, the date the Company obtained control of Qualitest.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the Qualitest Acquisition Date (in thousands):

	November 30, 2010 (As initially reported)	Measurement period adjustments	November 30, 2010 (As adjusted)
Cash and cash equivalents	\$ 21,828	\$	\$ 21,828
Accounts receivable	93,228		93,228
Other receivables	1,483		1,483
Inventories	95,000		95,000
Prepaid expenses and other current assets	2,023		2,023
Deferred income taxes	63,509	4,817	68,326
Property, Plant and equipment	135,807		135,807
Other intangible assets	843,000	(7,000)	836,000
<b>Total identifiable assets</b>	<b>\$ 1,255,878</b>	<b>\$ (2,183)</b>	<b>\$ 1,253,695</b>
Accounts payable	\$ 27,422	\$	\$ 27,422
Accrued expenses	55,210	1,012	56,222
Deferred income taxes	207,733	(2,758)	204,975
Long-term debt	406,758		406,758
Other liabilities	9,370		9,370
<b>Total liabilities assumed</b>	<b>\$ 706,493</b>	<b>\$ (1,746)</b>	<b>\$ 704,747</b>
Net identifiable assets acquired	\$ 549,385	\$ (437)	\$ 548,948
Goodwill	\$ 219,986	\$ 437	\$ 220,423
<b>Net assets acquired</b>	<b>\$ 769,371</b>	<b>\$</b>	<b>\$ 769,371</b>

The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the Qualitest Acquisition Date. The Company believes that information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the Qualitest Acquisition Date.

The valuation of the intangible assets acquired and related amortization periods are as follows:

	Valuation (in millions)	Amortization Period (in years)
<b>Developed Technology:</b>		
Hydrocodone and acetaminophen	\$ 119.0	17
Oxycodone and acetaminophen	30.0	17
Promethazine	46.0	16
Isosorbide Mononitrate ER	42.0	16
Multi Vitamins	38.0	16
Trazodone	17.0	16

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Butalbital, acetaminophen, and caffeine	25.0	16
Triprevifem	16.0	13
Spirolactone	13.0	17
Hydrocortisone	34.0	16
Hydrochlorothiazide	16.0	16
Controlled Substances	52.0	16
Oral Contraceptives	8.0	13
Others	162.0	17

**Table of Contents**

	Valuation (in millions)	Amortization Period (in years)
Total	\$ 618.0	16
<b>In Process Research &amp; Development:</b>		
Generics portfolio with anticipated 2011 launch	\$ 63.0	n/a
Generics portfolio with anticipated 2012 launch	30.0	n/a
Generics portfolio with anticipated 2013 launch	17.0	n/a
Generics portfolio with anticipated 2014 launch	88.0	n/a
Total	\$ 198.0	n/a
<b>Tradename:</b>		
Qualitest tradename	\$ 20.0	15
Total	\$ 20.0	15
Total other intangible assets	\$ 836.0	n/a

The fair value of the developed technology assets and in-process research and development assets were estimated using an income approach. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the intangible asset over its remaining useful life. To calculate fair value, the Company used probability-weighted cash flows discounted at rates considered appropriate given the inherent risks associated with each type of asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. Cash flows were generally assumed to extend through the shorter of the patent or estimated useful life of the developed technology or in-process research and development asset. The fair value of the Qualitest Tradename was estimated using an income approach, specifically known as the relief from royalty method. The relief from royalty method is based on a hypothetical royalty stream that would be received if the Company were to license the Qualitest Tradename. Thus, we derived the hypothetical royalty income from the projected revenues of Qualitest.

The \$220.4 million of goodwill was assigned to our Generics segment, which was established in November 2010 pursuant to our acquisition of Qualitest. The goodwill recognized is attributable primarily to expected purchasing, manufacturing and distribution synergies as well as their assembled workforce. Approximately \$170.4 million of goodwill is expected to be deductible for income tax purposes.

Deferred tax assets of \$68.3 million are related primarily to federal and state net operating loss and credit carryforwards of Qualitest and its subsidiaries. Deferred tax liabilities of \$205.0 million are related primarily to the difference between the book basis and tax basis of identifiable intangible assets.

The Company recognized \$3.2 million of Qualitest acquisition-related costs that were expensed for the three months ended March 31, 2011. These costs are included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations and are comprised of the following items (in thousands):

	Acquisition-related Costs Three months ended March 31, 2011
Investment bank fees, includes Endo and Qualitest	\$
Legal, separation, integration, and other costs	3,241
Total	\$ 3,241

The following supplemental pro forma information presents the financial results as if the acquisition of Qualitest had occurred on January 1, 2010 for the three months ended March 31, 2010. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made on January 1, 2010, nor are they indicative of any future results.

	<b>Three months ended March 31, 2010</b>	
<b>Pro forma consolidated results (in thousands, except per share data):</b>		
Revenue	\$	444,811
Net income attributable to Endo Pharmaceuticals Holdings Inc.	\$	59,784
Basic net income per share	\$	0.51
Diluted net income per share	\$	0.51



**Table of Contents**

These amounts have been calculated after applying the Company's accounting policies and adjusting the results of Qualitest to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments primarily to property, plant and equipment, and intangible assets, had been applied on January 1, 2010, together with the consequential tax effects.

**Penwest Pharmaceuticals Co.**

On September 20, 2010 (the Penwest Acquisition Date), the Company completed its tender offer for the outstanding shares of common stock of Penwest, at which time Penwest became a majority-owned subsidiary of the Company. On November 4, 2010, we closed this acquisition immediately following a special meeting of shareholders of Penwest at which they approved the merger. We paid approximately \$171.8 million in aggregate cash consideration. Penwest is now our wholly-owned subsidiary.

This transaction contributes to Endo's core pain management franchise and permits us to maximize the value of our oxymorphone franchise.

The operating results of Penwest from September 20, 2010 are included in the accompanying Condensed Consolidated Statements of Operations. The Condensed Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010 reflect the acquisition of Penwest, effective September 20, 2010, the date the Company obtained control of Penwest.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the Penwest Acquisition Date (in thousands):

	September 20, 2010 (As initially reported)	Measurement period adjustments	September 20, 2010 (As adjusted)
Cash and cash equivalents	\$ 22,343	\$	\$ 22,343
Marketable securities	800		800
Accounts receivable	10,885	(19)	10,866
Other receivables	132	(1)	131
Inventories	396	11	407
Prepaid expenses and other current assets	716	(223)	493
Deferred income taxes	27,175	3,003	30,178
Property and equipment	1,115	(200)	915
Other intangible assets	111,200		111,200
Other assets	2,104		2,104
<b>Total identifiable assets</b>	<b>\$ 176,866</b>	<b>\$ 2,571</b>	<b>\$ 179,437</b>
Accounts payable	\$ 229	\$	\$ 229
Income taxes payable	347	(187)	160
Penwest shareholder liability	20,815	(20,815)	
Accrued expenses	1,455	87	1,542
Deferred income taxes	39,951	379	40,330
Other liabilities	4,403	118	4,521
<b>Total liabilities assumed</b>	<b>\$ 67,200</b>	<b>\$ (20,418)</b>	<b>\$ 46,782</b>
<b>Net identifiable assets acquired</b>	<b>\$ 109,666</b>	<b>\$ 22,989</b>	<b>\$ 132,655</b>
Goodwill	\$ 37,952	\$ 1,159	\$ 39,111
<b>Net assets acquired</b>	<b>\$ 147,618</b>	<b>\$ 24,148</b>	<b>\$ 171,766</b>

The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the Penwest Acquisition Date to estimate the fair value of assets acquired and liabilities assumed. The Company believes that information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts, particularly with respect to intangible assets and deferred taxes. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon

as practicable but no later than one year from the Penwest Acquisition Date.

**Table of Contents**

The valuation of the intangible assets acquired and related amortization periods are as follows (in millions):

	Valuation	Amortization Period (in years)
<b>In Process Research &amp; Development:</b>		
Otsuka	\$ 5.5	n/a
A0001	1.6	n/a
Total	\$ 7.1	n/a
<b>Developed Technology:</b>		
Opana <sup>®</sup> ER	\$ 104.1	10
Total	\$ 104.1	10
Total other intangible assets	\$ 111.2	n/a

The fair values of the in-process research and development assets and developed technology asset were estimated using an income approach. To calculate fair value, the Company used probability-weighted cash flows discounted at rates considered appropriate given the inherent risks associated with the asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. Cash flows were generally assumed to extend through the shorter of the patent or estimated useful life of our developed technology or in-process research and development asset.

The \$39.1 million of goodwill was assigned to our Branded Pharmaceuticals segment. The goodwill recognized is attributable primarily to the control premium associated with our oxymorphone franchise and other factors. None of the goodwill is expected to be deductible for income tax purposes.

Deferred tax assets of \$30.2 million are related primarily to federal net operating loss and credit carryforwards of Penwest. Deferred tax liabilities of \$40.3 million are related primarily to the difference between the book basis and tax basis of the identifiable intangible assets.

The Company recognized less than \$0.1 million of Penwest acquisition-related costs that were expensed for the three months ended March 31, 2011. These costs are included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations.

Due to the pro forma impacts of eliminating the pre-existing intercompany royalties between Penwest and Endo, which were determined to be at fair value, we have not provided supplemental pro forma information as amounts are not material to the Condensed Consolidated Statements of Operations. We have also considered the impacts of Penwest, since the date we obtained a majority interest, on our Consolidated Statement of Operations and concluded amounts were not material.

***HealthTronics, Inc.***

On July 2, 2010 (the HealthTronics Acquisition Date), the Company completed its initial tender offer for all outstanding shares of common stock of HealthTronics and obtained effective control of HealthTronics. On July 12, 2010, Endo completed its acquisition of HealthTronics for approximately \$214.8 million in aggregate cash consideration for 100% of the outstanding shares, at which time HealthTronics became a wholly-owned subsidiary of the Company. HealthTronics shares were purchased at a price of \$4.85 per HealthTronics Share. In addition, Endo paid \$40 million to retire HealthTronics debt that had been outstanding under its Senior Credit Facility. As a result of the acquisition, the HealthTronics Senior Credit Facility was terminated.

HealthTronics is a provider of healthcare services and manufacturer of medical devices, primarily for the urology community. The HealthTronics business and applicable services include:

*Lithotripsy services.*

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

HealthTronics provides lithotripsy services, which is a medical procedure where a device called a lithotripter transmits high energy shockwaves through the body to break up kidney stones. Lithotripsy services are provided principally through limited partnerships and other entities that HealthTronics manages, which use lithotripters. In 2010, physician partners used our lithotripters to perform approximately 50,000 procedures in the U.S. While the physicians render medical services, HealthTronics does not. As the general partner of limited partnerships or the manager of other types of entities, HealthTronics also provide services relating to operating its lithotripters, including scheduling, staffing, training, quality assurance, regulatory compliance, and contracting with payors, hospitals, and surgery centers.

### *Prostate treatment services.*

HealthTronics provides treatments for benign and cancerous conditions of the prostate. In treating benign prostate disease, HealthTronics deploys three technologies in a number of its partnerships above: (1) photo-selective vaporization of the prostate (PVP), (2) trans-urethral needle ablation (TUNA), and (3) trans-urethral microwave therapy (TUMT). All three technologies apply an energy

**Table of Contents**

source which reduces the size of the prostate gland. For treating prostate and other cancers, HealthTronics uses a procedure called cryosurgery, a process which uses lethal ice to destroy tissue such as tumors for therapeutic purposes. In April 2008, HealthTronics acquired Advanced Medical Partners, Inc., which significantly expanded its cryosurgery partnership base. In July 2009, HealthTronics acquired Endocare, Inc., which manufactures both the medical devices and related consumables utilized by its cryosurgery operations and also provides cryosurgery treatments. The prostate treatment services are provided principally by using equipment that HealthTronics leases from limited partnerships and other entities that HealthTronics manages. Benign prostate disease and cryosurgery cancer treatment services are billed in the same manner as its lithotripsy services under either retail or wholesale contracts. HealthTronics also provides services relating to operating the equipment, including scheduling, staffing, training, quality assurance, regulatory compliance, and contracting.

*Radiation therapy services.*

HealthTronics provides image guided radiation therapy (IGRT) technical services for cancer treatment centers. Its IGRT technical services may relate to providing the technical (non-physician) personnel to operate a physician practice group's IGRT equipment, leasing IGRT equipment to a physician practice group, providing services related to helping a physician practice group establish an IGRT treatment center, or managing an IGRT treatment center.

*Anatomical pathology services.*

HealthTronics provides anatomical pathology services primarily to the urology community. HealthTronics has one pathology lab located in Georgia, which provides laboratory detection and diagnosis services to urologists throughout the United States. In addition, in July 2008, HealthTronics acquired Uropath LLC, now referred to as HealthTronics Laboratory Solutions, which managed pathology laboratories located at Uropath sites for physician practice groups located in Texas, Florida and Pennsylvania. Through HealthTronics Laboratory Solutions, HealthTronics continues to provide administrative services to in-office pathology labs for practice groups and pathology services to physicians and practice groups with its lab equipment and personnel at the HealthTronics Laboratory Solutions laboratory sites.

*Medical products manufacturing, sales and maintenance.*

HealthTronics manufactures and sells medical devices focused on minimally invasive technologies for tissue and tumor ablation through cryoablation, which is the use of lethal ice to destroy tissue, such as tumors, for therapeutic purposes. HealthTronics develops and manufactures these devices for the treatment of prostate and renal cancers and our proprietary technologies also have applications across a number of additional markets, including the ablation of tumors in the lung, liver metastases and palliative intervention (treatment of pain associated with metastases). HealthTronics manufactures the related spare parts and consumables for these devices. HealthTronics also sells and maintains lithotripters and related spare parts and consumables.

The acquisition of HealthTronics reflects Endo's desire to continue expanding our business beyond pain management into complementary medical areas where HealthTronics can be innovative and competitive. We believe this expansion will enable us to be a provider of multiple healthcare solutions and services that fill critical gaps in patient care.

The operating results of HealthTronics from July 2, 2010 are included in the accompanying Condensed Consolidated Statements of Operations. The Condensed Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010 reflect the acquisition of HealthTronics, effective July 2, 2010, the date the Company obtained control of HealthTronics.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the HealthTronics Acquisition Date (in thousands):

	July 2, 2010 (As initially reported)	Measurement period adjustments	July 2, 2010 (As Adjusted)
Cash and cash equivalents	\$ 6,769	\$	\$ 6,769
Accounts receivable	33,111	277	33,388
Other receivables	1,006		1,006
Inventories	12,399		12,399
Prepaid expenses and other current assets	5,204		5,204
Deferred income taxes	43,737	3,676	47,413

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Property and equipment	30,687		30,687
Other intangible assets	65,866	7,258	73,124
Other assets	5,210		5,210
Total identifiable assets	\$ 203,989	\$ 11,211	\$ 215,200
Accounts payable	\$ 3,084	\$	\$ 3,084
Accrued expenses	11,551	8,959	20,510

**Table of Contents**

	July 2, 2010 (As initially reported)	Measurement period adjustments	July 2, 2010 (As Adjusted)
Deferred income taxes	20,377	3,188	23,565
Long-term debt	44,751	(1,291)	43,460
Other liabilities	1,434	351	1,785
Total liabilities assumed	\$ 81,197	\$ 11,207	\$ 92,404
Net identifiable assets acquired	\$ 122,792	\$ 4	\$ 122,796
Noncontrolling interests	\$ (60,119)	\$ (3,108)	\$ (63,227)
Goodwill	\$ 152,170	\$ 3,104	\$ 155,274
Net assets acquired	\$ 214,843	\$	\$ 214,843

The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the HealthTronics Acquisition Date to estimate the fair value of assets acquired and liabilities assumed. The Company believes that information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts, particularly with respect to the estimated fair value of noncontrolling interests and deferred income taxes. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the HealthTronics Acquisition Date.

The valuation of the intangible assets acquired and related amortization periods are as follows:

	Valuation (in millions)	Amortization Period (in years)
Endocare Developed Technology	\$ 46.3	10
HealthTronics Tradename	14.6	15
Service Contract	12.2	n/a
Total	\$ 73.1	n/a

The fair value of the developed technology asset was estimated using a discounted present value income approach. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the intangible asset over its remaining useful life. To calculate fair value, the Company used probability-weighted cash flows discounted at rates considered appropriate given the inherent risks associated with each type of asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. Cash flows were assumed to extend through the patent life of the purchased technology. The fair value of the HealthTronics Tradename was estimated using an income approach, specifically known as the relief from royalty method. The relief from royalty method is based on a hypothetical royalty stream that would be received if the Company were to license the HealthTronics Tradename. Thus, we derived the hypothetical royalty income from the projected revenues of HealthTronics' services.

HealthTronics has investments in partnerships and limited liability companies (LLCs) where we, as the general partner or managing member, exercise effective control. Accordingly, we consolidate various entities where we do not own 100% of the entity in accordance with the accounting consolidation principles. As a result, we are required to fair value the noncontrolling interests as part of our purchase price allocation. To calculate fair value, the Company used historical transactions which represented Level 2 data points within the fair value hierarchy to calculate applicable multiples of each respective noncontrolling interest in the partnerships and LLCs.

The \$155.3 million of goodwill was assigned to our Devices and Services segment, which was established in July 2010 pursuant to our acquisition of HealthTronics. The goodwill recognized is attributable primarily to strategic and synergistic opportunities across the HealthTronics network of urology partnerships, expected corporate synergies, the assembled workforce of HealthTronics and other factors. Approximately \$33.6 million of goodwill is expected to be deductible for income tax purposes.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Deferred tax assets of \$47.4 million are related primarily to federal net operating loss and credit carryforwards of HealthTronics and its subsidiaries. Deferred tax liabilities of \$23.6 million are related primarily to the difference between the book basis and tax basis of identifiable intangible assets.



**Table of Contents**

The Company recognized \$1.4 million of HealthTronics acquisition-related costs that were expensed for the three months ended March 31, 2011. These costs are included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations and are comprised of the following items (in thousands):

	<b>Acquisition-related Costs Three months ended March 31, 2011</b>
Investment bank fees, includes Endo and HealthTronics	\$
Legal, separation, integration, and other costs	1,350
<b>Total</b>	<b>\$ 1,350</b>

The following supplemental pro forma information presents the financial results as if the acquisition of HealthTronics had occurred on January 1, 2010 for the three months ended March 31, 2010. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made on January 1, 2010, nor are they indicative of any future results.

	<b>Three months ended March 31, 2010</b>
<b>Pro forma consolidated results (in thousands, except per share data):</b>	
Revenue	\$ 412,801
Net income attributable to Endo Pharmaceuticals Holdings Inc.	\$ 61,708
Basic net income per share	\$ 0.53
Diluted net income per share	\$ 0.52

These amounts have been calculated after applying the Company's accounting policies and adjusting the results of HealthTronics to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments primarily to property, plant and equipment, and intangible assets, had been applied on January 1, 2010, together with the consequential tax effects.

**NOTE 6. SEGMENT RESULTS**

As a result of our recent acquisitions, the Company realigned its internal management reporting in 2010 to reflect a total of three reportable segments. These segments reflect the level at which executive management regularly reviews financial information to assess performance and to make decisions about resources to be allocated.

The three reportable business segments in which the Company now operates include: (1) Branded Pharmaceuticals, (2) Generics and (3) Devices and Services. Each segment derives revenue from the sales or licensing of their respective products or services and is discussed below.

***Branded Pharmaceuticals***

This group of products includes a variety of branded prescription products related to treating and managing pain as well as our urology, endocrinology and oncology products. The established products that are included in this operating segment includes Lidoderm®, Opana® ER and Opana®, Percocet®, Voltaren® Gel, Frova®, Supprelin® LA, Vantas®, and Valstar®.

**Table of Contents****Generics**

This segment is comprised of our legacy Endo non-branded generic portfolio and the portfolio from our newly acquired Qualitest business. Our generics business has historically focused on selective generics related to pain that have one or more barriers to market entry, such as complex formulation, regulatory or legal challenges or difficulty in raw material sourcing. With the addition of Qualitest, the segment's product offerings now include products in the pain management, urology, central nervous system (CNS) disorder, immunosuppression, oncology, and hypertension markets, among others.

**Devices and Services**

The Devices and Services operating segment provides urological services, products and support systems to urologists, hospitals, surgery centers and clinics across the United States. These services and products are sold through the five following business lines: lithotripsy services, prostate treatment services, radiation therapy services, anatomical pathology services, and medical products manufacturing, sales and maintenance. These business lines are discussed in greater detail within Note 5.

In 2010, the Company began to evaluate segment performance based on each segment's adjusted income (loss) before income tax. We define adjusted income (loss) before income tax as income (loss) before income tax before certain upfront and milestone payments to partners, acquisition-related items, cost reduction initiatives, asset impairment charges, amortization of commercial intangible assets related to marketed products, inventory step-up recorded as part of our acquisitions, non-cash interest expense, and certain other items that the Company believes do not reflect its core operating performance. Certain corporate general and administrative expenses are not allocated and are therefore included within Corporate unallocated. We calculate consolidated adjusted income (loss) before income tax by adding the adjusted income (loss) before income tax of each of our reportable segments to corporate unallocated adjusted income (loss) before income tax.

The following represents selected information for the Company's reportable segments for the three months ended March 31, 2011 and 2010 (in thousands):

	<b>Three months ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Net revenues to external customers</b>		
Branded Pharmaceuticals	\$ 375,514	\$ 338,536
Generics	134,409	25,876
Devices and Services	50,103	
<b>Total consolidated net revenues to external customers</b>	<b>\$ 560,026</b>	<b>\$ 364,412</b>
<b>Adjusted income (loss) before income tax</b>		
Branded Pharmaceuticals	\$ 193,256	\$ 169,324
Generics	26,387	3,246
Devices and Services	14,441	
Corporate unallocated	(56,269)	(44,354)
<b>Total consolidated adjusted income before income tax</b>	<b>\$ 177,815</b>	<b>\$ 128,216</b>

The table below provides reconciliations of our consolidated adjusted income (loss) before income tax to our consolidated income before income tax, which is determined in accordance with U.S. generally accepted accounting principles (GAAP), for the three months ended March 31, 2011 and 2010 (in thousands):

	<b>Three months ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Total consolidated adjusted income before income tax</b>	<b>\$ 177,815</b>	<b>\$ 128,216</b>
Upfront and milestone payments to partners	(11,001)	(3,000)

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Acquisition-related items	(6,073)	(1,529)
Cost reduction initiatives	(3,462)	(5,494)
Amortization of commercial intangible assets related to marketed products	(37,211)	(17,217)
Inventory step-up	(13,786)	
Non-cash interest expense	(4,541)	(4,050)
Other (expense) income		(204)
Total consolidated income before income tax	\$ 101,741	\$ 96,722

**Table of Contents**

The following represents additional selected financial information for our reportable segments three months ended March 31, 2011 and 2010 (in thousands):

	<b>Three months ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Depreciation expense</b>		
Branded Pharmaceuticals	\$ 3,667	\$ 3,338
Generics	2,613	204
Devices and Services	3,093	
Corporate unallocated	1,006	694
Total depreciation expense	\$ 10,379	\$ 4,236
<b>Amortization expense</b>		
Branded Pharmaceuticals	\$ 26,061	\$ 17,285
Generics	9,900	
Devices and Services	1,401	
Total amortization expense	\$ 37,362	\$ 17,285

Asset information is not accounted for at the segment level and consequently is not reviewed or included within our internal management reporting. Therefore, the Company has not disclosed asset information for each reportable segment.

**NOTE 7. INCOME TAXES**

The effective income tax rate on earnings from continuing operations before income taxes is 32.9% for the three months ended March 31, 2011 compared to 37.6% for the three months ended March 31, 2010.

The decrease in the effective income tax rate in the three months ended March 31, 2011, was due to:

A \$12.5 million benefit during the period ended March 31, 2011 for non-taxable income attributable to noncontrolling interests assumed as part of the HealthTronics acquisition;

A \$1.2 million benefit from the Research and Development credit during the period ended March 31, 2011. This credit expired on December 31, 2009, and was not reinstated until December 2010;

An increase of \$2.7 in the Domestic Production Activities deduction during the period ended March 31, 2011 compared to the comparable 2010 period; and

A \$0.7 million non-taxable gain resulting from decreases in contingent consideration during the period ended March 31, 2011, compared to a \$0.9 million non-deductible loss during the period ended March 31, 2010.

Partially offset by:

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

A \$2.8 million non-deductible charge during the period ended March 31, 2011 for the Branded Prescription Drug fee enacted in 2011 as part of Health Care Reform.

A \$1.1 million charge for non-deductible transaction costs related to our recent and pending acquisitions.

### **NOTE 8. LICENSE AND COLLABORATION AGREEMENTS**

#### ***Commercial Products***

*Novartis AG and Novartis Consumer Health, Inc.*

On March 4, 2008, we entered into a License and Supply Agreement (the Voltaren<sup>®</sup> Gel Agreement) with and among Novartis AG and Novartis Consumer Health, Inc (Novartis) to obtain the exclusive U.S. marketing rights for the prescription medicine Voltaren<sup>®</sup> Gel (Voltaren<sup>®</sup> Gel or Licensed Product). Voltaren<sup>®</sup> Gel received regulatory approval in October 2007 from the U.S. Food and Drug Administration (the FDA), becoming the first topical prescription treatment for use in treating pain associated with osteoarthritis and the first new product approved in the U.S. for osteoarthritis since 2001. Voltaren<sup>®</sup> Gel was granted marketing exclusivity in the U.S. as a prescription medicine until October 2010.

Under the terms of the five-year Voltaren<sup>®</sup> Gel Agreement, Endo made an upfront cash payment of \$85 million. Endo has agreed to pay royalties to Novartis on annual Net Sales of the Licensed Product, subject to certain thresholds as defined in the Voltaren<sup>®</sup> Gel Agreement. In addition, Endo has agreed to make certain guaranteed minimum annual royalty payments of \$30 million per year payable in the fourth and fifth year of the Voltaren<sup>®</sup> Gel Agreement, subject to certain limitations including the launch of a generic to the Licensed Product in the United States. These guaranteed minimum royalties will be creditable against royalty payments

## Table of Contents

on an annual basis such that Endo's obligation with respect to each year is to pay the greater of (i) royalties payable based on annual net sales of the Licensed Product or (ii) the guaranteed minimum royalty for such Voltaren® Gel Agreement year. No royalty payments were payable to Novartis during the three months ended March 31, 2011 or 2010. Novartis is also eligible to receive a one-time milestone payment of \$25 million if annual net sales of Voltaren® Gel exceed \$300 million in the U.S. The \$85 million upfront payment and the present value of the guaranteed minimum royalties have been capitalized as an intangible asset in the amount of \$129 million, representing the fair value of the exclusive license to market Voltaren® Gel. We are amortizing this intangible asset into cost of revenues over its estimated five-year useful life.

Endo is solely responsible to commercialize the Licensed Product during the term of the Voltaren® Gel Agreement. With respect to each year during the term of the Voltaren® Gel Agreement, Endo is required to incur a minimum amount of annual advertising and promotional expenses on the commercialization of the Licensed Product, subject to certain limitations. In addition, Endo is required to perform a minimum number of face-to-face one-on-one discussions with physicians and other healthcare practitioners (Details) for the purpose of promoting the Licensed Product within its approved indication during each year of the Voltaren® Gel Agreement. Further, during the term of the Voltaren® Gel Agreement, Endo will share in the costs of certain clinical studies and development activities initiated at the request of the FDA or as considered appropriate by Novartis and Endo.

During the term of the Voltaren® Gel Agreement, Endo has agreed to purchase all of its requirements for the Licensed Product from Novartis. The price was fixed for the first year and subject to annual changes based upon changes in the producer price index and raw materials.

Novartis has the exclusive right, at its sole discretion, to effect a switch of the Licensed Product from a prescription product to an over-the-counter (OTC) product in the United States (an OTC Switch) by filing an amendment or supplement to the Licensed Product New Drug Application or taking any other action necessary or advisable in connection therewith to effect the OTC Switch, and thereafter to commercialize such OTC product. Notwithstanding the foregoing, Novartis shall not launch an OTC equivalent product prior to a time specified in the Voltaren® Gel Agreement, and Novartis shall not take any action that results in the loss of the prescription product status for the Licensed Product prior to such time. Novartis will notify Endo if it submits a filing to the FDA in respect of an OTC equivalent product. In the event that Novartis gains approval of an OTC equivalent product that results in the Licensed Product being declassified as a prescription product, then Novartis will make certain royalty payments to Endo on net sales of such OTC equivalent product in the United States by Novartis, its affiliates and their respective licensees or sublicensees as set forth in the Voltaren® Gel Agreement. As a condition to the payment of any and all such royalties, net sales of the Licensed Product in the United States must have exceeded a certain threshold prior to the launch of the OTC equivalent product by Novartis or its affiliates.

The initial term of the Voltaren® Gel Agreement will expire on June 30, 2013. Endo has the option to extend the Voltaren® Gel Agreement for two successive one year terms. The Voltaren® Gel Agreement will remain in place after the first two renewal terms unless either party provides written notice of non-renewal to the other party at least six months prior to the expiration of any renewal term after the first renewal term or the Voltaren® Gel Agreement is otherwise terminated in accordance with its terms. Among other standard and customary termination rights granted under the Voltaren® Gel Agreement, the Voltaren® Gel Agreement can be terminated by either party upon reasonable written notice, if either party has committed a material breach that has not been remedied within ninety (90) days from the giving of written notice. Endo may terminate the Voltaren® Gel Agreement by written notice upon the occurrence of several events, including the launch in the United States of a generic to the Licensed Product. Novartis may terminate the Voltaren® Gel Agreement upon reasonable written notice (1) if Endo fails to deliver a set percentage of the minimum Details in any given six-month period under the Voltaren® Gel Agreement; or (2) on or after the launch in the United States of an OTC equivalent product by Novartis, its affiliates or any third party that does not result in the declassification of the Licensed Product as a prescription product, following which net sales in any six-month period under the Voltaren® Gel Agreement are less than a certain defined dollar amount.

### *Hind Healthcare Inc.*

In November 1998, Endo entered into a license agreement (the Hind License Agreement) with Hind Healthcare Inc. (Hind), for the sole and exclusive right to develop, use, market, promote and sell Lidoderm® in the United States. Under the terms of the Hind License Agreement, Endo paid Hind approximately \$10 million based upon the achievement of certain milestones and capitalized this amount as an intangible asset representing the fair value of these exclusive rights. In addition, Endo pays Hind nonrefundable royalties based on net sales of Lidoderm®. Royalties are recorded as a reduction to net sales due to the nature of the license agreement and the characteristics of the license involvement by Hind in Lidoderm®. The royalty rate is 10% of net sales through the shorter of (1) the expiration of the last licensed patent or (2) November 20, 2011, including a minimum royalty of at least \$500,000 per year. During the three-month periods ended March 31, 2011 and 2010 we recorded \$20.8 million and \$20.5 million for these royalties to Hind, respectively, which we recorded as a reduction to net pharmaceutical product sales. At March 31, 2011 and December 31, 2010, \$20.8 million and \$23.0 million, respectively, is recorded as a royalty payable and included in accounts payable in the accompanying Condensed Consolidated Balance Sheets. In March 2002, we extended this license with Hind to cover Lidoderm® in Canada and Mexico.



**Table of Contents***Vernalis Development Limited*

In July 2004, we entered into a License Agreement with Vernalis Development Limited (Vernalis) under which Vernalis agreed to license, exclusively to us, rights to market frovatriptan succinate (Frova<sup>®</sup>) in North America (the Vernalis License Agreement). Frova<sup>®</sup> was launched June 2002 in the U.S. and indicated for the acute treatment of migraine headaches in adults. Under the terms of the Vernalis License Agreement, we paid Vernalis an upfront fee of \$30 million and annual \$15 million payments each in 2005 and 2006. We capitalized the \$30 million up-front payment, the present value of the two \$15 million anniversary payments. We are amortizing this intangible asset into cost of revenues on a straight-line basis over its estimated life of twelve and one-half years.

Under the terms of the License Agreement we would have been required to make a \$40 million milestone payment upon FDA approval for the short-term prevention of menstrual migraine indication. In September 2007, the FDA issued to the Company and our development partner Vernalis, a not approvable letter pertaining to our supplemental new drug application (sNDA) for Frova<sup>®</sup> for the additional indication of short-term prevention of menstrual migraine. In April 2008, Endo notified the FDA of the withdrawal of the sNDA without prejudice to refile as afforded under 21 CFR 314.65 for Frova<sup>®</sup> 2.5 mg tablets. Frova<sup>®</sup> is approved and marketed for the acute treatment of migraine with or without aura in adults.

In addition, Vernalis could receive one-time milestone payments for the achievement of defined annual net sales targets. These sales milestone payments increase based on increasing net sales targets ranging from a milestone of \$10 million on \$200 million in net sales to a milestone of \$75 million on \$1.2 billion in net sales. These sales milestones could total up to \$255 million if all of the defined net sales targets are achieved. Beginning on January 1, 2007, we began paying royalties to Vernalis based on the net sales of Frova<sup>®</sup>. The term of the license agreement is for the shorter of the time (i) that there are valid claims on the Vernalis patents covering Frova<sup>®</sup> or there is market exclusivity granted by a regulatory authority, whichever is longer, or (ii) until the date on which a generic version of Frova<sup>®</sup> is first offered, but in no event longer than 20 years. We can terminate the license agreement under certain circumstances, including upon one years' written notice. In July 2007, Vernalis and Endo entered into an Amendment (Amendment No. 3) to the License Agreement dated July 14, 2004. Under Amendment No. 3, Vernalis granted an exclusive license to Endo to make, have made, use, commercialize and have commercialized the product Frova<sup>®</sup> in Canada, under the Canadian Trademark.

In February 2008, we entered into Amendment No. 4 to the Vernalis License Agreement (Amendment No. 4). In addition to amending certain specific terms and conditions of the License Agreement, Amendment No. 4 sets forth an annual minimum net sales threshold such that no royalties will be due on annual U.S. net sales of Frova<sup>®</sup> less than \$85 million. Prior to this amendment, royalties were payable by us to Vernalis on all net sales of Frova<sup>®</sup> in the United States. Now, once the annual minimum net sales amount is reached, royalty payments will be due only on the portion of annual net sales that exceed the \$85 million threshold.

*Allergan/Esprit*

In September 2007, Indevus (now, Endo Pharmaceuticals Solutions Inc.) entered into an Amended and Restated License, Commercialization and Supply Agreement with Esprit Pharma, Inc (Esprit), which modified the obligations of each party and superseded all previous agreements (the Allergan Agreement). In October 2007, Allergan, Inc. (Allergan) acquired Esprit resulting in Esprit being a wholly-owned subsidiary of Allergan. Under the Allergan Agreement, we received the right to receive a fixed percentage of net sales for the term of the Allergan Agreement, subject to increasing annual minimum royalties. Aggregate minimum royalties for the remainder of the Allergan Agreement amount to approximately \$88.5 million through December 31, 2014, provided there is no product adverse event, as defined in the Allergan Agreement. Commencing January 1, 2010, Allergan has the right to reduce, subject to quarterly and annual restrictions, royalty payments by \$20 million in the aggregate. The Company may also receive a payment of \$20 million related to a long-term commercialization milestone related to generic competition on December 31, 2013. Lastly, all third-party royalties paid by the Company as a result of existing licensing, manufacturing and supply agreements associated with sales of Sanctura<sup>®</sup> and Sanctura XR<sup>®</sup> will be reimbursed to the Company by Allergan up to six percent (6%) of net sales. The Allergan Agreement expires on the later of the twelfth annual anniversary of the launch of Sanctura XR<sup>®</sup> or February 1, 2025, the date of the last to expire patent covering Sanctura XR<sup>®</sup> in the United States. Either party may also terminate the Allergan Agreement in the event of a material breach by the other party. In August 2008, Indevus assigned its rights to receive a fixed percentage of net sales and \$20 million related to a long-term commercialization milestone related to generic competition to the holders of the Non-recourse Notes, which were redeemed during the fourth quarter of 2010.

In May 2008, together with Madaus AG, Indevus licensed to Allergan the exclusive right to develop, manufacture, and commercialize Sanctura XR<sup>®</sup> in Canada. As a result, the Company could receive milestones upon the achievement of certain sales thresholds of up to \$2 million. In addition, any third-party royalties owed by the Company on net sales in Canada will be reimbursed by Allergan. This agreement will expire after the later of the expiration of the last applicable patent or our third party royalty obligation, which is currently expected to be November 4, 2024, after which Allergan will have a fully-paid license.



*Madaus*

In November 1999, Indevus (now, Endo Pharmaceuticals Solutions Inc.) entered into an agreement with Madaus to license the exclusive rights to develop and market certain products, including Sanctura® in the United States. In November 2006, Indevus entered into (i) a License and Supply Agreement and (ii) an amendment to its original 1999 license agreement with Madaus (collectively, the Madaus Agreements). In March 2010, Endo amended the Madaus Agreements. Under the amended Madaus Agreements, (a) Madaus

## Table of Contents

has licensed the rights to sell Sanctura XR<sup>®</sup> in all countries outside of the U.S. (the Madaus Territory) except Canada, Japan, Korea and China (the Joint Territory), (b) Madaus has agreed to pay a fee based on the number of capsules of Sanctura XR<sup>®</sup> sold in the Madaus Territory through December 9, 2015 and (c) Endo has agreed to pay a fee based on the number of capsules of Sanctura XR<sup>®</sup> sold in the U.S. through the earlier of August 23, 2014 or upon generic formulations achieving a predetermined market share. In exchange, Madaus (a) agreed to make certain immaterial payments upon the achievement of certain commercial milestones and pay royalties of 5% of net sales based on future sales of Sanctura XR<sup>®</sup> in the Madaus Territory and (b) agreed to reimburse Endo for any amounts due to Supernus (see Supernus below) related to the development or commercialization in the Madaus territory. The Company and Madaus will share the development and commercialization costs in the countries in the Joint Territory. If either party decides not to pursue development and commercialization of Sanctura XR<sup>®</sup> in any country in the Joint Territory, the other party has the right to independently develop and commercialize Sanctura XR<sup>®</sup> in that country. The term of the Madaus Agreement for Sanctura XR<sup>®</sup> extends until the expiration, on a country-by-country basis, of all royalty obligations owed to the Company from Madaus which ceases upon the last to expire applicable patent in the Madaus Territory. Either party may terminate the amended Madaus Agreement in the event of a material breach by the other party.

### *Supernus*

In March 2003, Indevus (now, Endo Pharmaceuticals Solutions Inc.) entered into a Development and License Agreement (the Supernus Agreement) with Supernus Pharmaceuticals, Inc. (Supernus) pursuant to which Supernus agreed to develop Sanctura XR<sup>®</sup> and granted exclusive, worldwide rights under certain Supernus patents and know-how to Indevus. The Supernus agreement includes potential future development and commercialization milestone payments from the Company to Supernus, including royalties based on sales of Sanctura XR<sup>®</sup>, and potential future development and commercialization milestone payments for up to an aggregate of \$2.4 million upon the launch of Sanctura XR<sup>®</sup> in certain geographic areas. In addition, the Supernus agreement includes potential future development and commercialization milestone payments for up to an aggregate of \$4.5 million upon the launch of new formulations and over-the-counter products. The Company is responsible for all development costs and the commercialization of Sanctura XR<sup>®</sup> under the Supernus agreement. The Supernus agreement continues until the earlier of, in any particular country, (i) the last date on which the manufacture, use or sale of licensed product in such country would infringe a valid claim of a licensed patent in such country but for the license granted by the agreement; or (ii) twelve years from the date of first commercial sale of licensed product in such country. Either party may also terminate this agreement in the event of a material breach by the other party or by mutual consent.

### *The Population Council*

The Company markets its products utilizing the hydrogel polymer technology pursuant to an agreement between Indevus (now, Endo Pharmaceuticals Solutions Inc.) and the Population Council. Unless earlier terminated by either party in the event of a material breach by the other party, the term of the agreement is the shorter of twenty-five years from October 1997 or until the date on which The Population Council receives approximately \$40 million in payments from the Company. The Company is required to pay to The Population Council 3% of its net sales of Vantas<sup>®</sup> and any polymer implant containing an LHRH analog. We are also obligated to pay royalties to the Population Council ranging from 0.5% of net sales to 4% of net sales under certain conditions. We are also obligated to pay the Population Council 30% of certain profits and payments received in certain territories by the Company from the licensing of Vantas<sup>®</sup> or any other polymer implant containing an LHRH analog and 5% for other implants.

### *Strakan International Limited*

In August 2009, we entered into a License and Supply Agreement with Strakan International Limited, a subsidiary of ProStrakan Group plc. (ProStrakan), for the exclusive right to commercialize Fortesta<sup>™</sup> Gel in the U.S. (the ProStrakan Agreement). Fortesta<sup>™</sup> Gel, a patented two percent (2%) testosterone transdermal gel for testosterone replacement therapy in male hypogonadism. A metered dose delivery system permits accurate dose adjustment to increase the ability to individualize patient treatment. Under the terms of the ProStrakan Agreement, Endo paid ProStrakan an up-front cash payment of \$10 million, which was recorded as research and development expense.

In October 2009, we received a complete response letter from the FDA regarding the NDA for Fortesta<sup>™</sup> Gel. The FDA issues complete response letters to communicate that their initial review of an NDA or abbreviated new drug application (ANDA) is complete and that the application cannot be approved in its present form. A complete response also informs applicants of changes that must be made before an application can be approved, with no implication regarding the ultimate approvability of the application.

Following the July 1, 2010 complete response to the FDA, the Company received FDA approval in December 2010. As of December 31, 2010, the Company accrued and capitalized the one-time approval milestone to ProStrakan for \$12.5 million. ProStrakan could potentially receive up to approximately \$175.0 million in additional payments linked to the achievement of future commercial milestones related to Fortesta<sup>™</sup> Gel. We are amortizing this intangible asset into cost of revenues on a straight-line basis over its estimated useful life.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

ProStrakan will exclusively supply Fortesta™ Gel to Endo at a supply price based on a percentage of annual net sales subject to a minimum floor price as defined in the ProStrakan Agreement. Endo may terminate the ProStrakan Agreement upon six months prior written notice at no cost to the Company.

**Table of Contents*****Products in Development******Grünenthal GMBH***

In February 2009, we entered into a Development, License and Supply Agreement (the Grünenthal Agreement) with Grünenthal GMBH (Grünenthal), granting us the exclusive right in North America to develop and market Grünenthal's investigational drug, axomadol. Currently in Phase II trials, axomadol is a patented new chemical entity being developed for the treatment of moderate to moderately-severe chronic pain and diabetic peripheral neuropathic pain. Under the terms of the Grünenthal Agreement, Endo paid Grünenthal approximately \$9.4 million upfront and an additional \$25.2 million in 2009 upon the achievement of certain milestones. We could be obligated to pay additional clinical, regulatory and approval milestone payments of up to approximately 6.3 million euros (approximately \$8.9 million at March 31, 2011) and possibly development and commerce milestone payments of up to an additional \$68.0 million. In addition, Grünenthal will receive payments from Endo based on a percentage of Endo's annual net sales of the product in the United States and Canada. The Grünenthal Agreement will expire in its entirety on the date of (i) the 15th anniversary of the first commercial sale of the product; or (ii) the expiration of the last issued patent claiming or covering the product, or (iii) the expiration of exclusivity granted by the FDA for the product, whichever occurs later. Among other standard and customary termination rights granted under the Grünenthal Agreement, we may terminate the Grünenthal Agreement at our sole discretion at any time upon ninety (90) days' written prior notice to Grünenthal and payment of certain penalties.

In December 2007, we entered into a license, development and supply agreement with Grünenthal for the exclusive clinical development and commercialization rights in Canada and the United States for a new oral formulation of long-acting oxymorphone, which is designed to be crush resistant. Under the terms of this agreement Grünenthal is responsible for development efforts to conduct pharmaceutical formulation development and will manufacture any such product or products which obtain FDA approval. Endo is responsible for conducting clinical development activities and for all development costs incurred to obtain regulatory approval. Under the terms of the agreement, we paid approximately \$4.9 million for the successful completion of a clinical milestone in 2010, which was recorded as research and development expense. Additional payments of approximately 59.2 million euros (approximately \$83.5 million at March 31, 2011) may become due upon achievement of predetermined regulatory and commercial milestones. Endo will also make payments to Grünenthal based on net sales of any such product or products commercialized under this agreement.

***Impax Laboratories, Inc.***

In June 2010, the Company entered into a Development and Co-Promotion Agreement (the Impax Agreement) with Impax Laboratories, Inc. (Impax), whereby the Company was granted a royalty-free license for the co-exclusive rights to co-promote a next generation Parkinson's disease product. Under the terms of the Impax Agreement, Endo paid Impax an upfront payment of \$10 million in 2010, which was recorded as research and development expense. The Company could be obligated to pay up to approximately \$30 million in additional payments linked to the achievement of future clinical, regulatory, and commercial milestones related to the development product. Prior to the completion of Phase III trials, Endo may only terminate the Impax Agreement upon a material breach.

***Bioniche Life Sciences Inc.***

In July 2009, the Company entered into a License, Development and Supply Agreement (the Bioniche Agreement) with Bioniche Life Sciences Inc. and Bioniche Urology Inc. (collectively, Bioniche), whereby the Company licensed from Bioniche the exclusive rights to develop and market Bioniche's proprietary formulation of Mycobacterial Cell Wall-DNA Complex (MCC), known as Urocidin<sup>TM</sup>, in the U.S. with an option for global rights. We exercised our option for global rights in the first quarter of 2010. Urocidin<sup>TM</sup> is a patented formulation of MCC developed by Bioniche for the treatment of non-muscle-invasive bladder cancer that is currently undergoing Phase III clinical testing. Under the terms of the Bioniche Agreement, Endo paid Bioniche an up-front cash payment of \$20.0 million in July 2009 and milestone payments of \$4.0 million in 2010 resulting from the achievement of contractual milestones, both of which were recorded as research and development expense. In addition, Bioniche could potentially receive up to approximately \$67.0 million and \$29.0 million in additional payments linked to the achievement of future clinical, regulatory, and commercial milestones related to two separate indications for Urocidin<sup>TM</sup>. Bioniche will manufacture Urocidin<sup>TM</sup> and receive a transfer price for supply based on a percentage of Endo's annual net sales of Urocidin<sup>TM</sup>. Endo may terminate the Bioniche Agreement upon 180 days' prior written notice.

***BayerSchering***

In July 2005, Indevus (now, Endo Pharmaceuticals Solutions Inc.) licensed exclusive U.S. rights from Schering AG, Germany, now BayerSchering Pharma AG (BayerSchering) to market a long-acting injectable testosterone preparation for the treatment of male hypogonadism that we refer to as Aveed<sup>TM</sup> (the BayerSchering Agreement). The Company is responsible for the development and commercialization of Aveed<sup>TM</sup> in the United States. BayerSchering is responsible for manufacturing and supplying the Company with finished product. As part of the

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

BayerSchering Agreement, Indevus agreed to pay to BayerSchering up to \$30.0 million in up-front, regulatory milestone, and commercialization milestone payments, including a \$5.0 million payment due upon approval by the FDA to market Aveed™. Indevus also agreed to pay to BayerSchering 25% of net sales of Aveed™ to cover both the cost of finished product and royalties. The BayerSchering Agreement expires ten years from the first commercial sale of Aveed™. Either party may also terminate the BayerSchering Agreement in the event of a material breach by the other party.

---

**Table of Contents**

In October 2006, Indevus entered into a supply agreement with BayerSchering pursuant to which BayerSchering agreed to manufacture and supply Indevus with all of its requirements for Aveed™ for a supply price based on net sales of Aveed™. The supply price is applied against the 25% of net sales owed to BayerSchering pursuant to the BayerSchering Agreement. The BayerSchering Agreement expires ten years after the first commercial sale of Aveed™.

*Sanofi-Aventis*

In February 1994, Indevus (now, Endo Pharmaceuticals Solutions Inc.) licensed from Rhone-Poulenc Rorer, S.A., now Aventis Pharma S.A. (Sanofi-Aventis), exclusive, worldwide rights for the manufacture, use and sale of pagoclone under patent rights and know-how related to the drug, except that Indevus granted Sanofi-Aventis an option to sublicense, under certain conditions, rights to market pagoclone in France. Indevus paid Sanofi-Aventis a license fee and agreed to make milestone payments based on clinical and regulatory developments, and to pay royalties based on net sales through the expiration of the composition of matter patent. If sublicensed, the Company would pay to Sanofi-Aventis a portion of receipts from the sublicensee in lieu of payments. Under the terms of the agreement with Sanofi-Aventis, the Company is responsible for all costs of developing, manufacturing, and marketing pagoclone. This agreement expires with respect to each country upon the last to expire applicable patent. Additionally either party may also terminate this agreement in the event of a material breach by the other party. The Company could owe an additional \$11.1 million if certain clinical and regulatory development milestones are achieved, as well as royalties on net sales or a percentage of royalties it receives if the product is sublicensed.

*Hydron Technologies, Inc.*

In November 1989, GP Strategies Corporation (GP Strategies), then known as National Patent Development Corporation, entered into an agreement (the Hydron Agreement) with Dento-Med Industries, Inc., now known as Hydron Technologies, Inc. In June 2000, Valera Pharmaceuticals, Inc. (Valera, now a wholly-owned subsidiary of the Company known as Endo Pharmaceuticals Valera Inc.) entered into a contribution agreement with GP Strategies, pursuant to which Valera acquired the assets of GP Strategies' drug delivery business, including all intellectual property, and all of GP Strategies' rights under the Hydron Agreement, and certain other agreements with The Population Council and Shire US, Inc.

Pursuant to the Hydron Agreement, the Company has the exclusive right to manufacture, sell and distribute any prescription drug or medical device and certain other products made with hydrogel polymer technology. Hydron Technologies retained an exclusive, worldwide license to manufacture, market, or use products composed of, or produced with the use of, hydrogel polymer technology in certain consumer and oral health fields. Neither party is prohibited from manufacturing, exploiting, using or transferring the rights to any new non-prescription drug product containing hydrogel polymer technology, subject to certain exceptions, for limited exclusivity periods. Subject to certain conditions and exceptions, the Company is obligated to supply certain types of polymer to Hydron Technologies and Hydron Technologies is obligated to purchase such products from the Company. Under the Hydron Agreement, the Company also has the title to the Hydron® trademark and must maintain such trademark throughout the world. The Company has decided to stop using the Hydron® trademark and will transfer the title to such trademark to Hydron Technologies pursuant to the Hydron Agreement. This agreement continues indefinitely, unless terminated earlier by the parties. Each party may owe royalties up to 5% to the other party on certain products under certain conditions.

*Orion Corporation*

In January 2011, the Company entered into a Discovery, Development and Commercialization Agreement (the 2011 Orion Agreement) with Orion Corporation (Orion) to exclusively co-develop products for the treatment of certain cancers and solid tumors. Under the terms of the 2011 Orion Agreement, Endo and Orion each contributed four research programs to the collaboration to be conducted pursuant to the agreement. The development of each research program shall initially be the sole responsibility of the contributing party. However, upon the achievement of certain milestones, the non-contribution party shall have the opportunity to, at its option, obtain a license to jointly develop and commercialize any research program contributed by the other party for amounts defined in the 2011 Orion Agreement. Subject to certain limitations, upon the first commercial sale of any successfully launched jointly developed product, Endo shall be obligated to pay royalties to Orion based on net sales of the corresponding product in North America (the Endo territory) and Orion shall be obligated to pay royalties to Endo on net sales of the corresponding product in certain European countries (the Orion territory). The 2011 Orion Agreement shall expire in January 2016, unless terminated early or extended pursuant to the terms of the agreement. In January 2011, Endo exercised its option to obtain a license to jointly develop and commercialize Orion's Anti-Androgen program focused on castration-resistant prostate cancer, one of Orion's four contributed research programs, and made a corresponding payment to Orion for \$10 million, which was expensed in the first quarter of 2011.

*Teva Pharmaceutical Industries Ltd*

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

On November 30, 2010 (the Qualitest Acquisition Date), Endo acquired Qualitest, who was party to an asset purchase agreement with Teva Pharmaceutical Industries Ltd (Teva) (the Teva Agreement). Pursuant to this agreement, Qualitest purchased certain pipeline generic products from Teva and could be obligated to pay consideration to Teva upon the achievement of certain future regulatory milestones. As of March 31, 2011, the maximum amount we could be obligated to pay under the Teva Agreement is \$12.5 million.

**Table of Contents***EpiCept Corp.*

In December 2003, we entered into a license granting us exclusive, worldwide rights to certain patents of EpiCept Corp. (EpiCept) as well as exclusive, worldwide commercialization rights to EpiCept's LidoPAIN<sup>®</sup> BP product (EpiCept Agreement). The EpiCept Agreement provides for Endo to pay EpiCept milestones as well as royalties on the net sales of EpiCept's LidoPAIN<sup>®</sup> BP product. Under this Agreement, we made an upfront payment to EpiCept of \$7.5 million which we capitalized as an intangible asset representing the fair value of the exclusive right and the patents. We are amortizing this intangible asset over its useful life of thirteen (13) years. EpiCept has also retained an option to co-promote the LidoPAIN<sup>®</sup> BP product. Milestone payments made by Endo under this agreement, including regulatory milestones and sales thresholds, could total up to \$82.5 million. In addition, the EpiCept Agreement also contains terms and conditions customary for this type of arrangement, including representations, warranties, indemnities and termination rights. The EpiCept Agreement generally lasts until the underlying patents expire. In January 2009, EpiCept announced that it was discontinuing all drug discovery activities including the development of LidoPAIN<sup>®</sup> BP. However, the Company intends to maintain its patent rights conveyed by the EpiCept Agreement.

*Other*

We have entered into certain other collaboration and discovery agreements with third parties for the development of pain management and other products. These agreements require us to share in the development costs of such products and grant marketing rights to us for such products.

We have also licensed from universities and other similar firms rights to certain technologies or intellectual property generally in the field of pain management. We are generally required to make upfront payments as well as other payments upon successful completion of regulatory or sales milestones. In addition, these agreements generally require us to pay royalties on sales of the products arising from these agreements. These agreements generally permit Endo to terminate the agreement with no significant continuing obligation.

In July 2008, the Company made a \$20 million investment in a privately-held company focused on the development of an innovative treatment for certain types of cancer. In exchange for our \$20 million payment, we received an equity interest in the privately-held company. The Company's \$20 million payment resulted in an ownership interest of less than 20% of the outstanding voting stock of the privately-held company. In addition, Endo and other equity holders have provided a line of credit totaling \$25 million, of which Endo committed to fund \$3 million. During 2010, \$2.5 million was funded by Endo under the line-of credit, which could be converted into equity of the privately-held company upon certain events. During January of 2011, an additional payment of \$0.3 million was subsequently funded under the same commitment. In March 2011, we received a \$0.8 million distribution from our investment, which was recorded as a reduction to the investment balance. Based on the equity ownership structure, Endo does not have the ability to exert significant influence over the privately-held company. Pursuant to authoritative accounting guidance, our investment constitutes a variable interest in this privately-held company. We have determined that Endo is not the primary beneficiary and therefore have not consolidated the assets, liabilities, and results of operations of the privately-held company into our Condensed Consolidated Financial Statements. Accordingly, Endo is accounting for this investment under the cost method. As of March 31, 2011, our investment in the privately-held company was \$22.0 million, representing our maximum exposure to loss.

**NOTE 9. GOODWILL AND OTHER INTANGIBLES**

Changes in the carrying amount of our goodwill for the three months ended March 31, 2011, are as follows:

(in thousands)	Gross carrying amount
Balance at December 31, 2010	\$ 715,005
Measurement period adjustments	2,337
Other	1,958
Balance at March 31, 2011	\$ 719,300

Our other intangible assets consist of the following at March 31, 2011 and December 31, 2010, respectively (in thousands):

March 31, 2011	December 31, 2010
-------------------	----------------------



Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

<b>Indefinite-lived intangibles:</b>		
In-process research and development	\$ 271,000	\$ 271,000
Tradenames		27,000
<i>Total indefinite-lived intangibles</i>	\$ 271,000	\$ 298,000
<b>Definite-lived intangibles:</b>		
Licenses (weighted average life of 10 years)	638,142	638,142
Less accumulated amortization	(203,419)	(185,706)

**Table of Contents**

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Licenses, net	\$ 434,723	\$ 452,436
Tradenames (weighted average life of 15 years)	34,600	14,600
Less accumulated amortization	(1,172)	(486)
Tradenames, net	\$ 33,428	\$ 14,114
Developed technology (weighted average life of 15 years)	768,400	768,400
Less accumulated amortization	(33,518)	(14,614)
Developed technology, net	\$ 734,882	\$ 753,786
Service contract	12,166	13,424
Less accumulated amortization		
Service contract, net	\$ 12,166	\$ 13,424
<i>Total definite-lived intangibles, net (weighted average life of 13 years)</i>	<i>\$ 1,215,199</i>	<i>\$ 1,233,760</i>
Other intangibles, net	\$ 1,486,199	\$ 1,531,760

Amortization expense for the three month periods ended March 31, 2011 and 2010 was \$37.4 million and \$17.3 million, respectively. As of March 31, 2011, the weighted average amortization period for our definite-lived intangible assets in total was approximately 13 years.

Changes in the gross carrying amount of our other intangible assets for the three months ended March 31, 2011, are as follows:

<b>(in thousands)</b>	<b>Gross carrying amount</b>
Balance at December 31, 2010:	\$ 1,732,566
Measurement period adjustments	(8,258)
<b>Balance at March 31, 2011</b>	<b>\$ 1,724,308</b>

Estimated amortization of intangibles for the five fiscal years subsequent to December 31, 2010 is as follows (in thousands):

2011	\$ 148,650
2012	\$ 148,218
2013	\$ 106,444
2014	\$ 93,590
2015	\$ 93,336

**NOTE 10. COMPREHENSIVE INCOME**

Comprehensive income includes the following components for the three months ended March 31, 2011 and 2010 (in thousands):

	<b>March 31, 2011</b>	<b>March 31, 2010</b>
Consolidated net income	\$ 68,295	\$ 60,355

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Other comprehensive income (loss):		
Unrealized gain (loss) on securities, net of tax	150	468
Consolidated total comprehensive income	\$ 68,445	\$ 60,823
Less: Total comprehensive income attributable to noncontrolling interests	12,508	
Comprehensive income attributable to Endo Pharmaceuticals Holdings Inc.	\$ 55,937	\$ 60,823

### NOTE 11. STOCKHOLDERS EQUITY

#### *Stock-Based Compensation*

##### *Endo Pharmaceuticals Holdings Inc. 2000, 2004, 2007, and 2010 Stock Incentive Plans*

On August 11, 2000, we established the Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan. The 2000 Stock Incentive Plan reserved an aggregate of 4,000,000 shares of common stock of the Company for issuance to employees, officers, directors and consultants. The 2000 Stock Incentive Plan provided for the issuance of stock options, restricted stock, stock bonus

**Table of Contents**

awards, stock appreciation rights or performance awards. The 2000 Stock incentive expired during 2010. In May 2004, our stockholders approved the Endo Pharmaceuticals Holdings Inc. 2004 Stock Incentive Plan. The maximum number of shares of Company stock reserved for issuance under the 2004 Stock Incentive Plan is 4,000,000 shares. The 2004 Plan provides for the grant of stock options, stock appreciation rights, shares of restricted stock, performance shares, performance units or other share-based awards that may be granted to executive officers and other employees of the Company, including officers and directors who are employees, to non-employee directors and to consultants to the Company. In May 2007, our stockholders approved the Endo Pharmaceuticals Holdings Inc. 2007 Stock Incentive Plan. The maximum number of shares of Company stock reserved for issuance under the 2007 Stock Incentive Plan is 7,000,000 shares (subject to adjustment for certain transactions), but in no event may the total number of shares of Company stock subject to awards awarded to any one participant during any tax year of the Company exceed 750,000 shares (subject to adjustment for certain transactions). During 2009, 43,500 restricted stock units and 66,503 non-qualified stock options were granted to an executive officer of the Company as an inducement to commence employment with the Company. The restricted stock units and non-qualified stock options were granted outside of the 2007 Stock Incentive Plan but are subject to the terms and conditions of the 2007 Stock Incentive Plan and the applicable award agreements. In May 2010, our stockholders approved the Endo Pharmaceuticals Holdings Inc. 2010 Stock Incentive Plan. The maximum number of shares of Company stock reserved for issuance under the Plan includes 8,000,000 shares plus the number of shares of Company stock reserved but unissued under the Company's 2004 and 2007 Stock Incentive Plans as of April 28, 2010 and may be increased to include the number of shares of Company stock that become available for reuse under these plans following April 28, 2010, subject to adjustment for certain transactions. Notwithstanding the foregoing, of the 8,000,000 shares originally reserved for issuance under this Plan, no more than 4,000,000 of such shares shall be issued as awards, other than options, that are settled in the Company's stock. In no event may the total number of shares of Company stock subject to awards awarded to any one participant during any tax year of the Company, exceed 1,000,000 shares (subject to adjustment for certain transactions). Approximately 17.6 million shares were reserved for future issuance upon exercise of options granted or to be granted under the 2000, 2004, 2007, and 2010 Stock Incentive Plans. As of March 31, 2011, stock options, restricted stock awards, performance stock units and restricted stock units have been granted under the Stock Incentive Plans.

The Company accounts for its stock-based compensation plans in accordance with the applicable accounting guidance. Accordingly, all stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense in the income statement over the requisite service period.

The Company recognized stock-based compensation expense of \$7.4 million and \$3.8 million, during the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011, the total remaining unrecognized compensation cost related to all non-vested stock-based compensation awards amounted to \$100.3 million. This expected cost does not include the impact of any future stock-based compensation awards.

*Stock Options*

For all of the Company's stock-based compensation plans, the fair value of each option grant was estimated at the date of grant using the Black-Scholes option-pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield (which is assumed to be zero, as the Company has not paid cash dividends to date and does not currently expect to pay cash dividends) and the expected term of the option. Expected volatilities utilized in the model are based mainly on the historical volatility of the Company's stock price over a period commensurate with the expected life of the share option as well as other factors. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the time of grant. We estimate the expected term of options granted based on our historical experience with our employees' exercise of stock options and other factors.

A summary of the activity under 2000, 2004, 2007, and 2010 Stock Incentive Plans for the three months ended March 31, 2011 is presented below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, January 1, 2011	5,891,400	\$ 22.60		
Granted	1,411,055	\$ 34.00		
Exercised	(539,620)	\$ 23.00		
Forfeited	(69,201)	\$ 21.23		
Expired	(13,807)	\$ 22.12		

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Outstanding, March 31, 2011	6,679,827	\$	24.99	7.98	\$ 87,524,455
Vested and expected to vest, March 31, 2011	6,107,726	\$	24.68	7.85	\$ 81,902,179
Exercisable, March 31, 2011	2,375,085	\$	23.57	6.25	\$ 34,484,732

**Table of Contents**

The total intrinsic value of options exercised during the three months ended March 31, 2011 and 2010 was \$6.9 million and \$0.4 million, respectively. The weighted-average grant date fair value of the stock options granted in the three months ended March 31, 2011 and 2010 was \$10.88 per option and \$7.36 per option, respectively, determined using the following assumptions:

	2011	2010
Average expected term (years)	5.0	5.3
Risk-free interest rate	2.2%	2.6%
Dividend yield	0.00	0.00
Expected volatility	32%	34%

The weighted average remaining requisite service period of the non-vested stock options was 2.9 years. As of March 31, 2011, the total remaining unrecognized compensation cost related to non-vested stock options amounted to \$36.4 million. This unrecognized compensation cost does not include the impact of any future stock-based compensation awards.

*Restricted Stock Units*

A summary of our restricted stock units as of March 31, 2011 is presented below:

	Number of Shares	Aggregate Intrinsic Value
Outstanding, January 1, 2011	2,211,303	
Granted	746,240	
Forfeited	(48,431)	
Vested	(470,493)	
Outstanding, March 31, 2011	2,438,619	\$ 92,886,998
Vested and expected to vest, March 31, 2011	2,083,208	\$ 78,438,881

The weighted average remaining requisite service period of the non-vested restricted stock units was 2.8 years. The weighted-average grant date fair value of the restricted stock units granted during the three months ended March 31, 2011 and 2010 was \$33.99 per unit and \$20.71 per unit, respectively. As of March 31, 2011, the total remaining unrecognized compensation cost related to non-vested restricted stock units amounted to \$54.3 million. This unrecognized compensation cost does not include the impact of any future stock-based compensation awards.

*Performance Shares*

Beginning in the first quarter ended March 31, 2010, the Company began to award performance stock units (PSU) to certain key employees. These PSUs are tied to both Endo's overall financial performance and Endo's financial performance relative to the financial performance of a selected industry group. Awards are granted annually, with each award covering a three-year performance cycle. Each PSU is convertible to one share of Endo common stock. Performance measures used to determine the actual number of performance shares issuable upon vesting include an equal weighting of Endo's total shareholder return (TSR) performance compared to the performance group over the three-year performance cycle and Endo's three-year cumulative revenue performance as compared to a three-year revenue target. TSR relative to peers is considered a market condition while cumulative revenue performance is considered a performance condition under applicable authoritative guidance. PSUs granted for the three months ended March 31, 2011 and 2010 totaled approximately 160,000 and 163,000, respectively. As of March 31, 2011, there was approximately \$9.6 million of total unrecognized compensation costs related to PSUs. That cost is expected to be recognized over a weighted-average period of 3.0 years.

*Share Repurchase Program*

In April 2008, our Board of Directors approved a share repurchase program, authorizing the Company to repurchase in the aggregate up to \$750 million of shares of its outstanding common stock. Purchases under this program may be made from time to time in open market purchases, privately-negotiated transactions, and accelerated stock repurchase transactions or otherwise, as determined by Endo.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

This program does not obligate Endo to acquire any particular amount of common stock. Additional purchases, if any, will depend on factors such as levels of cash generation from operations, cash requirements for investment in the Company's business, repayment of future debt, if any, current stock price, market conditions and other factors. The share repurchase program may be suspended, modified or discontinued at any time. As a result of a two-year extension approved by the Board of Directors in February 2010, the share repurchase plan is set to expire in April 2012.

**Table of Contents**

Pursuant to the existing share repurchase program, we purchased approximately 0.5 million shares of our common stock during the period ended March 31, 2011 totaling \$17.6 million and approximately 1.2 million shares of our common stock during the period ended March 31, 2010 totaling \$29.0 million.

**Changes in Stockholders' Equity**

The following table displays a reconciliation of our beginning and ending balances in stockholders' equity for the three months ended March 31, 2011 (dollars in thousands):

	Attributable to:		
	Endo Pharmaceuticals Holdings Inc.	Noncontrolling interests	Total Stockholders Equity
Stockholders' equity at January 1, 2011	\$ 1,741,591	\$ 61,738	\$ 1,803,329
Net income	55,787	12,508	68,295
Other comprehensive income	150		150
Compensation related to stock-based awards	7,416		7,416
Exercise of options	12,336		12,336
Common stock purchased	(17,552)		(17,552)
Distributions to noncontrolling interests		(12,627)	(12,627)
Buy-out of noncontrolling interests, net of contributions		(261)	(261)
Other	2,637		2,637
Stockholders' equity at March 31, 2011	\$ 1,802,365	\$ 61,358	\$ 1,863,723

**NOTE 12. COMMITMENTS AND CONTINGENCIES****Manufacturing, Supply and Other Service Agreements**

We contract with various third party manufacturers and suppliers to provide us with raw materials, used in our products, and also to provide semi-finished and finished goods. Our most significant agreements are with Novartis Consumer Health, Inc. and Novartis AG (collectively, Novartis), Teikoku Seiyaku Co., Ltd., Mallinckrodt Inc., Noramco, Inc., Sharp Corporation, and Ventiv Commercial Services, LLC. If for any reason we are unable to obtain sufficient quantities of any of the finished goods or raw materials or components required for our products, it could have a material adverse effect on our business, financial condition, results of operations and cash flows.

*Novartis Consumer Health, Inc.*

On May 3, 2001, we entered into a long-term manufacturing and development agreement with Novartis Consumer Health, Inc. whereby Novartis Consumer Health, Inc. has agreed to manufacture certain of our commercial products and products in development. We are required to purchase, on an annual basis, a minimum amount of product from Novartis Consumer Health, Inc. The purchase price per product is equal to a predetermined amount per unit, subject to periodic adjustments. This agreement had a five-year initial term, with automatic five-year renewals thereafter. In August 2005, we extended this agreement until 2011. On February 23, 2011, we gave notice to Novartis that we would terminate this agreement effective February 2014. As of March 31, 2011, based on the currently manufactured products at Novartis Consumer Health, Inc. we are required to purchase a minimum of approximately \$14 million of product from Novartis Consumer Health Inc. per year, or pro rata portion thereof, until the effective date of the termination of this agreement.

Pursuant to the March 2008 Voltaren® Gel License and Supply Agreement (the Voltaren® Gel Agreement) with Novartis AG and Novartis Consumer Health, Inc. Endo has agreed to purchase from Novartis all of its requirements for Voltaren® Gel during the entire term of the Voltaren® Gel Agreement. The price of product purchased under the Voltaren® Gel Agreement is fixed for the first year and subject to annual changes based upon changes in the producer price index and raw materials.

As part of the Voltaren® Gel Agreement, we also agreed to undertake advertising and promotion of Voltaren® Gel (A&P Expenditures), subject to certain thresholds set forth in the Voltaren® Gel Agreement. We agreed to spend a minimum of \$15.0 million on A&P Expenditures during



## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

the first Voltaren® Gel Agreement Year which ended on June 30, 2009. During the second Voltaren® Gel Agreement Year beginning on July 1, 2009 and extended through June 30, 2010, we had agreed to spend a minimum of \$20 million on A&P Expenditures. During the third Voltaren® Gel Agreement Year beginning on July 1, 2010 and extending through June 30, 2011, we had agreed to spend 15% of prior year sales or approximately \$13 million on A&P Expenditures. In subsequent Agreement Years, the minimum A&P Expenditures set forth in the Voltaren® Gel Agreement are determined based on a percentage of net sales of Voltaren® Gel. Amounts incurred by Endo for such A&P Expenditures were \$6.9 million and \$4.5 million for the three months ended March 31, 2011 and 2010, respectively.

## **Table of Contents**

### *Teikoku Seiyaku Co., Ltd.*

Under the terms of our agreement (the Teikoku Agreement) with Teikoku Seiyaku Co. Ltd. (Teikoku), a Japanese manufacturer, Teikoku manufactures Lidoderm® at its two Japanese facilities, located on adjacent properties, for commercial sale by us in the United States. We also have an option to extend the supply area to other territories. On April 24, 2007, we amended the Teikoku agreement (the Amended Agreement). The material components of the Amended Agreement are as follows:

We agreed to purchase a minimum number of patches per year through 2012, representing the noncancelable portion of the Amended Agreement.

Teikoku agreed to fix the supply price of Lidoderm® for a period of time after which the price will be adjusted at future dates certain based on a price index defined in the Amended Agreement. Since future price changes are unknown, we have used prices currently existing under the Amended Agreement, and estimated our minimum purchase requirement to be approximately \$32 million per year through 2012. The minimum purchase requirement shall remain in effect subsequent to 2012, except that Endo has the right to terminate the Amended Agreement after 2012, if we fail to meet the annual minimum requirement.

Following cessation of our obligation to pay royalties to Hind Healthcare Inc. (Hind) under the Sole and Exclusive License Agreement dated as of November 23, 1998, as amended, between Hind and Endo, we will pay to Teikoku annual royalties based on our annual net sales of Lidoderm®.

The Amended Agreement will expire on December 31, 2021, unless terminated in accordance with its terms. Either party may terminate this Agreement, upon thirty (30) days written notice, in the event that Endo fails to purchase the annual minimum quantity for each year after 2012 (e.g., 2013 through 2021) upon thirty (30) days written notice. Notwithstanding the foregoing, after December 31, 2021, the Amended Agreement shall be automatically renewed on the first day of January each year unless (i) we and Teikoku agree to terminate the Amended Agreement upon mutual written agreement or (ii) either we or Teikoku terminates the Amended Agreement with 180-day written notice to the other party, which notice shall not in any event be effective prior to July 1, 2022.

On January 6, 2010, the parties amended the Teikoku Agreement, effective December 16, 2009. Pursuant to the amendment, Teikoku has agreed to supply the product at a fixed price for a period of time after which the price will be adjusted at future dates certain based on a price index defined in the amendment.

Effective November 1, 2010, the parties amended the Teikoku Agreement. Pursuant to this amendment, Teikoku has agreed to supply additional product at no cost to Endo in each of 2011, 2012 and 2013 in the event Endo's firm orders of Product exceed certain thresholds in those years.

### *Mallinckrodt Inc.*

Under the terms of our agreement (the Mallinckrodt Agreement) with Mallinckrodt Inc. (Mallinckrodt), Mallinckrodt manufactures and supplies to us certain narcotic active drug substances, in bulk form, and raw materials for inclusion in our controlled substance pharmaceutical products. There is no minimum annual purchase commitment under the Mallinckrodt Agreement. However, we are required to purchase a fixed percentage of our annual requirements of each narcotic active drug substance covered by the Mallinckrodt Agreement from Mallinckrodt. The purchase price for these substances is equal to a fixed amount, adjusted on an annual basis. The initial term of this agreement is July 1, 1998 until June 30, 2013, with an automatic renewal provision for unlimited successive one-year periods. Either party may terminate the Mallinckrodt Agreement in the event of a material breach by the other party.

### *Noramco, Inc.*

Under the terms of our agreement (the Noramco Agreement) with Noramco Inc. (Noramco), Noramco manufactures and supplies to us certain narcotic active drug substances, in bulk form, and raw materials for inclusion in our controlled substance pharmaceutical products. There are no minimum annual purchase commitments under the Noramco Agreement. However, we are required to purchase a fixed percentage of our annual requirements of each narcotic active drug substance covered by the Noramco Agreement from Noramco. The purchase price for these substances

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

is equal to a fixed amount, adjusted on an annual basis. The Noramco Agreement will expire on December 31, 2011, with automatic renewal provisions for unlimited successive one-year periods. Either party may terminate the Noramco Agreement in the event of a material breach by the other party or at a designated time prior to its termination date.

### *Sharp Corporation*

Under the terms of our agreement (the Sharp Agreement) with Sharp Corporation (Sharp), a U.S. manufacturer, Sharp performs certain services for Endo including the packaging and labeling of Lidoderm® at its facility in Allentown, Pennsylvania, for commercial sale by us in the United States. The Sharp Agreement will expire on March 15, 2015, subject to renewal for additional one-year periods upon mutual agreement by both parties. Endo has the right to terminate the Sharp Agreement at any time upon ninety (90) days written notice. On December 6, 2010, the parties amended the Sharp Packaging and Labeling agreement, effective December 1, 2010, extending the agreement until March 1, 2015.

---

## **Table of Contents**

### *Ventiv Commercial Services, LLC*

On May 15, 2008, we entered into a services agreement (the 2008 Ventiv Agreement) with Ventiv Commercial Services, LLC (Ventiv). Under the terms of the 2008 Ventiv Agreement, Ventiv provided to Endo certain sales and marketing services through a contracted field force and other sales management positions, collectively referred to as the 2008 Ventiv Field Force. The 2008 Ventiv Field Force promoted primarily Voltaren® Gel and was required to perform a minimum number of face-to-face one-on-one discussions with physicians and other healthcare practitioners for the purpose of promoting Voltaren® Gel and other Endo products within their respective approved indications during each year of the 2008 Ventiv Agreement, subject to certain provisions.

Under the terms of the 2008 Ventiv Agreement, we incurred a one-time implementation fee that we recognized in Selling, general, and administrative expense in the second quarter of 2008. In addition, each month we were required to pay Ventiv a monthly fixed fee during the term of the 2008 Ventiv Agreement based on a pre-approved budget. Included in the fixed monthly fee were certain costs such as the Ventiv sales representative and district manager salaries, 2008 Ventiv Field Force travel, and office and other expenses captured on routine expense reports, as well as a fixed management fee. Ventiv was also eligible to earn a performance-based bonus equal to the fixed management fee during each year of the 2008 Ventiv Agreement. This performance-based bonus was payable upon the satisfaction of certain conditions, including the sale of a minimum number of Voltaren® Gel tubes and a minimum number of Details achieved.

In May 2009, we amended the 2008 Ventiv Agreement to change certain provisions including a reduction in the 2008 Ventiv Field Force from 275 to 80 sales representatives effective June 1, 2009. On September 30, 2010, the term of the Ventiv Agreement, which was originally set to expire on August 10, 2010, was extended until the first to occur of the following: (i) Endo and Ventiv entering into the new services agreement or (ii) November 30, 2010. On November 24, 2010, Endo and Ventiv terminated the 2008 Ventiv Agreement and entered into a new services agreement (the 2010 Ventiv Agreement).

Under the terms of the 2010 Ventiv Agreement, Ventiv provides to Endo certain sales and promotional services through a contracted field force of 228 sales representatives, 24 district managers, one project manager, and one national sales director, collectively referred to as the 2010 Ventiv Field Force. The 2010 Ventiv Field Force is required to perform a minimum number of face-to-face, one-on-one discussions with physicians and other health care practitioners for the purpose of promoting Voltaren® Gel, Lidoderm®, Frova®, Opana® ER, and other Endo products within their respective approved indications during each year of the 2010 Ventiv Agreement, subject to certain provisions.

Under the terms of the 2010 Ventiv Agreement, we incurred a one-time implementation fee that we recognized in Selling, general, and administrative expense in the second half of 2010. In addition, each month we are required to pay Ventiv a monthly fixed fee during the term of the 2010 Ventiv Agreement based on a pre-approved budget. Ventiv is also eligible to earn a performance-based bonus equal to the fixed management fee during each year of the 2010 Ventiv Agreement. This performance-based bonus is payable upon the satisfaction of certain conditions, including the sale of a minimum number of Voltaren® Gel tubes and a minimum number of Details achieved. The 2010 Ventiv Agreement shall expire on October 1, 2011, unless extended by Endo.

The expenses incurred with respect to Ventiv under both the 2008 Ventiv Agreement and the 2010 Ventiv Agreement totaled \$8.8 million and \$2.5 million for the three months ended March 31, 2011 and March 31, 2010, respectively, and is included within Selling, general and administrative expense in the accompanying Condensed Consolidated Statements of Operations.

### *UPS Supply Chain Solutions*

Under the terms of this agreement, we utilize UPS Supply Chain Solutions to provide customer service support, chargeback processing, accounts receivables management and warehouse, freight and distribution services for certain of our products in the United States. The initial term of the agreement will extend to March 31, 2015. The agreement may be terminated by either party (1) without cause upon prior written notice to the other party; (2) with cause in the event of an uncured material breach by the other party and (3) if the other party become insolvent or bankrupt. In the event of termination of services provided under the Warehouse Distribution Services Schedule to the agreement (i) by Endo without cause or (ii) by UPS due to Endo's breach, failure by Endo to make payments when due, or Endo's insolvency, we would be required to pay UPS certain termination costs. Such termination costs would not exceed \$1.5 million.

### *General*

In addition to the manufacturing and supply agreements described above, we have agreements with various companies for clinical development services. Although we have no reason to believe that the parties to these agreements will not meet their obligations, failure by any of these third parties to honor their contractual obligations may have a materially adverse effect on our business, financial condition, results of operations and cash flows.



## **Table of Contents**

### **Milestones and Royalties**

See Note 8 for a complete description of future milestone and royalty commitments pursuant to our acquisitions, license and collaboration agreements.

### **Employment Agreements**

We have entered into employment agreements with certain members of management.

### **Research Contracts**

We routinely contract with universities, medical centers, contract research organizations and other institutions for the conduct of research and clinical studies on our behalf. These agreements are generally for the duration of the contracted study and contain provisions that allow us to terminate prior to completion.

### **Legal Proceedings**

In the ordinary course of its business, the Company is involved in various claims and legal proceedings, including product liability, intellectual property, and commercial litigation. While we cannot predict the outcome of our ongoing legal proceedings and we intend to vigorously defend our position, an adverse outcome in any of these proceedings could have a material adverse effect on our current and future financial position, results of operations and cash flows.

#### *Withdrawal of Redux, Legal Proceedings, Insurance Claims, and Related Contingencies*

In September 1997, Indevus announced a market withdrawal of its first commercial prescription product, the anti-obesity medication Redux (dexfenfluramine hydrochloride capsules C-IV), which had been launched in June 1996 by its licensee, American Home Products Corporation, which became Wyeth, and was later acquired by Pfizer. The withdrawal of Redux was based on a preliminary analysis by the FDA of potential abnormal echocardiogram findings associated with certain patients taking Redux or the combination of fenfluramine with phentermine. Following the withdrawal of Redux, Indevus was named, together with other pharmaceutical companies, as a defendant in several thousand product liability legal actions in federal and state courts relating to the use of Redux and other weight loss drugs. Fewer than 50 cases are still pending against Indevus and/or the Company. In May 2001, Indevus entered into the AHP Indemnity and Release Agreement with Wyeth pursuant to which Wyeth agreed to indemnify Indevus against certain classes of product liability cases filed against Indevus related to Redux and Indevus agreed to dismiss Redux related claims against Wyeth. Under the terms of the AHP Indemnity and Release Agreement, Wyeth has agreed to indemnify Indevus for claims brought by plaintiffs who initially opted out of Wyeth's national class action settlement of diet drug claims and claimants alleging primary pulmonary hypertension. In addition, Wyeth has agreed to fund all future legal costs of Indevus related to the defense of Redux-related product liability cases. Also, pursuant to the AHP Indemnity and Release Agreement, Wyeth agreed to fund through May 30, 2012 additional insurance coverage to supplement Indevus' existing product liability insurance. The Company believes the total insurance coverage, including the additional insurance coverage funded by Wyeth, is sufficient to address the potential remaining Redux product liability exposure. However, there can be no assurance Redux claims will not exceed the amount of insurance coverage available to the Company and Wyeth's indemnification obligations under the AHP Indemnity and Release Agreement. If such insurance coverage and Wyeth indemnification is not sufficient to satisfy Redux-related claims, the payment of amounts to satisfy such claims may have an adverse effect on the Company's business, results of operations, financial condition or cash flows. Prior to the effectiveness of the AHP Indemnity and Release Agreement, Redux-related defense costs of Indevus were paid by, or subject to reimbursement from, Indevus' product liability insurers. To date, there have been no Redux-related product liability settlements or judgments paid by Indevus, the Company or their insurers.

If Indevus incurs additional product liability defense and other costs subject to claims on the Reliance product liability policy up to the \$5.0 million limit of the policy, Indevus will have to pay such costs without expectation of reimbursement and will incur charges to operations for all or a portion of such payments.

#### *Department of Health and Human Services Subpoena*

In January 2007 and April 2011, the Company received a subpoena issued by the United States Department of Health and Human Services, Office of Inspector General (OIG) and the United States Department of Justice, respectively. The subpoena requests documents relating to Lidoderm® (lidocaine patch 5%), focused primarily on the sale, marketing and promotion of Lidoderm®. The Company is cooperating with the government. At this time, the Company cannot predict or determine the outcome of the above matter or reasonably estimate the amount or range of amounts of fines or penalties, if any, that might result from a settlement or an adverse outcome.

*Pricing Litigation*

A number of cases brought by local and state government entities are pending that allege generally that our wholly-owned subsidiary, Endo Pharmaceuticals Inc. (EPI) and numerous other pharmaceutical companies reported false pricing information in connection with certain drugs that are reimbursable under Medicaid. These cases generally seek damages, treble damages, disgorgement of profits, restitution and attorneys fees.

## Table of Contents

The federal court cases have been consolidated in the United States District Court for the District of Massachusetts under the Multidistrict Litigation Rules as In re: *Pharmaceutical Industry Average Wholesale Price Litigation, MDL 1456*. The following previously reported cases are pending in MDL 1456 and have been consolidated into one consolidated complaint: *City of New York v. Abbott Laboratories, Inc., et al.*; *County of Albany v. Abbott Laboratories, Inc., et al.*; *County of Allegany v. Abbott Laboratories, Inc., et al.*; *County of Broome v. Abbott Laboratories, Inc., et al.*; *County of Cattaraugus v. Abbott Laboratories, Inc., et al.*; *County of Cayuga v. Abbott Laboratories, Inc., et al.*; *County of Chautauqua v. Abbott Laboratories, Inc., et al.*; *County of Chemung v. Abbott Laboratories, Inc., et al.*; *County of Chenango v. Abbott Laboratories, Inc., et al.*; *County of Columbia v. Abbott Laboratories, Inc., et al.*; *County of Cortland v. Abbott Laboratories, Inc., et al.*; *County of Dutchess v. Abbott Laboratories, Inc., et al.*; *County of Essex v. Abbott Laboratories, Inc., et al.*; *County of Fulton v. Abbott Laboratories, Inc., et al.*; *County of Genesee v. Abbott Laboratories, Inc., et al.*; *County of Greene v. Abbott Laboratories, Inc., et al.*; *County of Herkimer v. Abbott Laboratories, Inc., et al.*; *County of Jefferson v. Abbott Laboratories, Inc., et al.*; *County of Lewis v. Abbott Laboratories, Inc., et al.*; *County of Madison v. Abbott Laboratories, Inc., et al.*; *County of Monroe v. Abbott Laboratories, Inc., et al.*; *County of Niagara v. Abbott Laboratories, Inc., et al.*; *County of Oneida v. Abbott Laboratories, Inc., et al.*; *County of Onondaga v. Abbott Laboratories, Inc., et al.*; *County of Ontario v. Abbott Laboratories, Inc., et al.*; *County of Orleans v. Abbott Laboratories, Inc., et al.*; *County of Putnam v. Abbott Laboratories, Inc., et al.*; *County of Rensselaer v. Abbott Laboratories, Inc., et al.*; *County of Rockland v. Abbott Laboratories, Inc., et al.*; *County of St. Lawrence v. Abbott Laboratories, Inc., et al.*; *County of Saratoga v. Abbott Laboratories, Inc., et al.*; *County of Schuyler v. Abbott Laboratories, Inc., et al.*; *County of Seneca v. Abbott Laboratories, Inc., et al.*; *County of Steuben v. Abbott Laboratories, Inc., et al.*; *County of Suffolk v. Abbott Laboratories, Inc., et al.*; *County of Tompkins v. Abbott Laboratories, Inc., et al.*; *County of Ulster v. Abbott Laboratories, Inc., et al.*; *County of Warren v. Abbott Laboratories, Inc., et al.*; *County of Washington v. Abbott Laboratories, Inc., et al.*; *County of Wayne v. Abbott Laboratories, Inc., et al.*; *County of Westchester v. Abbott Laboratories, Inc., et al.*; *County of Wyoming v. Abbott Laboratories, Inc., et al.*; and *County of Yates v. Abbott Laboratories, Inc., et al.*

In addition, a previously reported case originally filed in the Southern District of New York, *County of Orange v. Abbott Laboratories, Inc., et al.*, has been transferred to the MDL and consolidated with the cases listed above.

On January 22, 2010, without admitting any liability or wrongdoing, EPI and the plaintiffs reached an agreement in principle to resolve the foregoing federal cases brought by New York City and the New York counties on terms that are not material to the Company's business, results of operations, financial condition or cash flows.

On November 3, 2010, the State of Louisiana submitted its Third Amending Petition for Damages and Jury Demand in the previously-filed case of *State of Louisiana v. Abbott Laboratories, Inc., et al.*, No. 596164. That Petition names EPI as a defendant. The Petition also names numerous other pharmaceutical companies and contains allegations similar to the allegations in the cases described above. The case is pending in the 19th Judicial District, Parish of East Baton Rouge.

There is a previously reported case pending in the MDL against EPI and numerous other pharmaceutical companies: *State of Iowa v. Abbott Laboratories, Inc., et al.*, Civ. Action No. 4:07-cv-00461. On June 25, 2010, without admitting any liability or wrongdoing, EPI and the plaintiff reached an agreement in principle to resolve this case brought by the State of Iowa on terms that are not material to the Company's business, results of operations, financial condition or cash flows.

Three previously reported cases, *County of Erie v. Abbott Laboratories, Inc., et al.*, originally filed in the Supreme Court of the State of New York, Erie County, *County of Oswego v. Abbott Laboratories, Inc., et al.*, originally filed in the Supreme Court of the State of New York, Oswego County, and *County of Schenectady v. Abbott Laboratories, Inc., et al.*, originally filed in the Supreme Court of the State of New York, Schenectady County, have been coordinated by the New York Litigation Coordinating Panel in the Supreme Court of the State of New York, Erie County. Without admitting any liability or wrongdoing, EPI and the plaintiffs have reached an agreement in principle to resolve these cases brought by the County of Erie, the County of Oswego and the County of Schenectady on terms that are not material to the Company's business, results of operations, financial condition or cash flows.

There is a previously reported case pending in the Circuit Court of Montgomery County, Alabama against EPI and numerous other pharmaceutical companies: *State of Alabama v. Abbott Laboratories, Inc., et al.*

There is a previously reported case pending in the Third Judicial District Court of Salt Lake County, Utah against EPI and numerous other pharmaceutical companies: *State of Utah v. Actavis US, Inc., et al.*, Civ. Action No. 070913719.

The Company intends to contest the above unresolved cases vigorously and to explore other options as appropriate in the best interests of the Company. Litigation similar to that described above may also be brought by other plaintiffs in various jurisdictions. However, we cannot predict the timing or outcome of any such litigation, or whether any such litigation will be brought against the Company.



*Paragraph IV Certifications on Lidoderm®*

On January 15, 2010, the Company and the holders of the Lidoderm® NDA and relevant patent, Teikoku Seiyaku Co., Ltd., and Teikoku Pharma USA, Inc. (Teikoku) received a Paragraph IV Certification Notice under 21 U.S.C. 355(j) from Watson Laboratories, Inc. advising of the filing of an Abbreviated New Drug Application (ANDA) for a generic version Lidoderm® (lidocaine topical patch

**Table of Contents**

5%). The Paragraph IV Certification Notice refers to U.S. Patent No. 5,827,529, which covers the formulation of Lidoderm<sup>®</sup>, a topical patch to relieve the pain of post herpetic neuralgia launched in 1999. This patent is listed in the FDA's Orange Book and expires in October 2015. As a result of this Notice, on February 19, 2010, the Company, Teikoku Seiyaku Co., Ltd. and Teikoku Pharma USA, Inc. filed a lawsuit against Watson Laboratories, Inc. in the United States District Court of the District of Delaware. Because the suit was filed within the 45-day period under the Hatch-Waxman Act for filing a patent infringement action, we believe that it triggered an automatic 30-month stay of approval under the Act. On March 4, 2010, Watson filed an Answer and Counterclaims, claiming U.S. Patent No. 5,827,529 is invalid or not infringed. In October 2010, Teikoku Pharma USA listed U.S. Patent No. 5,741,510 in the FDA Orange Book, and this patent expires in March 2014. This patent has not yet been challenged. Endo intends, and has been advised by Teikoku that they too intend, to defend Lidoderm<sup>®</sup>'s intellectual property rights and to pursue all available legal and regulatory avenues in defense of Lidoderm<sup>®</sup>, including enforcement of the product's intellectual property rights and approved labeling. However, there can be no assurance that we will be successful. Additionally, we cannot predict or determine the timing or outcome of this litigation but will explore all options as appropriate in the best interests of the Company.

In January 2011, the Company and Teikoku received a Paragraph IV Certification Notice under 21 U.S.C. 355(j) from Mylan Technologies Inc. (Mylan) advising of the filing of an ANDA for a generic version of Lidoderm<sup>®</sup> (lidocaine topical patch 5%). The Paragraph IV Certification Notice refers to U.S. Patent Nos. 5,827,529 and 5,741,510, which cover the formulation of Lidoderm<sup>®</sup>. These patents are listed in the FDA's Orange Book and expire in October 2015 and March 2014, respectively. On March 14, 2011, the Company filed a lawsuit against Mylan in the United States District Court for the District of Delaware, claiming that the Paragraph IV Certification Notice served by Mylan failed to comply with the requirements of 21 U.S.C. sec. 355(b)(3)(C)(1) and 21 C.F.R. 214.95(a). In that suit, the Company seeks a declaration that Mylan's Paragraph IV Certification Notice is null, void and without legal effect, and that as a result, Mylan has failed to properly trigger the ANDA litigation process. In the alternative, the Company alleges that Mylan's submission of its ANDA constitutes infringement of the '510 patent under 35 U.S.C. sec. 271(e)(2)(A). The Company intends, and has been advised by Teikoku that it too intends, to pursue all available legal and regulatory pathways in defense of Lidoderm<sup>®</sup>. However, there can be no assurance that we will be successful. If we are unsuccessful and Mylan is able to obtain FDA approval of its product, it may be able to launch its generic version of Lidoderm<sup>®</sup> prior to the applicable patents' expirations in 2014 and 2015.

In addition to the above litigation, it is possible that another generic manufacturer may also seek to launch a generic version of Lidoderm<sup>®</sup> and challenge the applicable patents.

*Paragraph IV Certifications on Opana<sup>®</sup> ER*

On December 14, 2007, the Company received a notice from Impax Laboratories, Inc. (Impax) advising of the FDA's apparent acceptance for substantive review, as of November 23, 2007, of Impax's amended ANDA for a generic version of Opana<sup>®</sup> ER (oxymorphone hydrochloride extended-release tablets CII). Impax's letter included notification that it had filed Paragraph IV certifications with respect to Penwest's U.S. Patent Nos. 7,276,250, 5,958,456 and 5,662,933, which cover the formulation of Opana<sup>®</sup> ER. These patents are listed in the FDA's Orange Book and expire in 2023, 2013 and 2013, respectively.

On June 16, 2008, the Company received a notice from Impax that it had filed an amendment to its ANDA containing Paragraph IV certifications for the 7.5 mg, 15 mg and 30 mg strengths of oxymorphone hydrochloride extended release tablets. The Company and Penwest timely filed lawsuits against Impax in the United States District Court for the District of Delaware in connection with Impax's ANDAs.

On June 8, 2010, the Company and Penwest settled all of the Impax litigation relating to Opana<sup>®</sup> ER. Both sides dismissed their respective claims and counterclaim with prejudice. Under the terms of the settlement, Impax agreed not to challenge the validity or enforceability of Penwest's patents relating to Opana<sup>®</sup> ER. The Company and Penwest agreed to grant Impax a license permitting the production and sale of generic Opana<sup>®</sup> ER for 5, 10, 20, 30 and 40 mg tablets commencing on January 1, 2013 or earlier under certain circumstances. Such license is exclusive for 5, 10, 20, 30 and 40 mg tablets of generic Opana<sup>®</sup> ER for which Impax obtains first applicant status as described in 21 U.S.C. Section 355(j)(5)(B)(iv), for the period beginning on January 1, 2013 or earlier under certain circumstances, and such exclusivity ends upon expiration or forfeit of the 180-day period described in 21 U.S.C. Section 355(j)(5)(B)(iv) for such dosage strength. Such license is also subject to any agreements executed by us and/or Penwest and any third party holding an ANDA referencing Opana<sup>®</sup> ER as of or prior to June 8, 2010.

In February 2008, the Company received a notice from Actavis South Atlantic LLC (Actavis), advising of the filing by Actavis of an ANDA containing a Paragraph IV certification under 21 U.S.C. Section 355(j) for a generic version of Opana<sup>®</sup> ER (oxymorphone hydrochloride extended-release tablets CII).

On or around June 2, 2008, the Company received a notice from Actavis that it had filed an amendment to its ANDA containing Paragraph IV certifications for the 7.5 mg and 15 mg dosage strengths of oxymorphone hydrochloride extended release tablets. On or around July 2, 2008, the Company received a notice from Actavis that it had filed an amendment to its ANDA containing a Paragraph IV certification for the 30 mg dosage strength. The Company and Penwest timely filed lawsuits against Actavis in the United States District Court for the District of New

Jersey.

## **Table of Contents**

On February 20, 2009, the Company and Penwest settled all of the Actavis litigation relating to Opana® ER. Under the terms of the settlement, Actavis agreed not to challenge the validity or enforceability of Penwest's patents relating to Opana® ER. The Company and Penwest agreed to grant Actavis a license permitting the production and sale of generic Opana® ER 7.5 and 15 mg tablets on July 15, 2011, or earlier under certain circumstances. The Company and Penwest also granted Actavis a license to produce and market other strengths of Opana® ER generic commencing on the earlier of July 15, 2011 and the date on which any third party commences commercial sales of a generic form of the drug.

On July 14, 2008, the Company received a notice from Sandoz, Inc. (Sandoz), advising of the filing by Sandoz of an ANDA containing a Paragraph IV certification under 21 U.S.C. Section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in 5 mg, 10 mg, 20 mg and 40 mg dosage strengths.

On November 20, 2008, the Company received a notice from Sandoz that it had filed an amendment to its ANDA containing Paragraph IV certifications for the 7.5 mg, 15 mg and 30 mg dosage strengths of oxymorphone hydrochloride extended release tablets. The Company and Penwest timely filed lawsuits against Sandoz in the United States District Court for the District of Delaware.

On June 8, 2010, the Company and Penwest settled all of the Sandoz litigation relating to Opana® ER. Both sides dismissed their respective claims and counterclaim with prejudice. Under the terms of the settlement, Sandoz agreed not to challenge the validity or enforceability of Penwest's patents relating to Opana® ER. The Company and Penwest agreed to grant Sandoz a license permitting the production and sale of all strengths of Opana® ER commencing on September 15, 2012, or earlier under certain circumstances.

On September 12, 2008, the Company received a notice from Barr Laboratories, Inc. (Barr), advising of the filing by Barr of an ANDA containing a Paragraph IV certification under 21 U.S.C. Section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in a 40 mg dosage strength. On September 15, 2008, the Company received a notice from Barr that it had filed an ANDA containing a Paragraph IV certification under 21 U.S.C. Section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in 5 mg, 10 mg, and 20 mg dosage strengths. On June 2, 2009, the Company received a notice from Barr that it had filed an ANDA containing a Paragraph IV certification under 21 U.S.C. Section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in 7.5 mg, 15 mg, and 30 mg dosage strengths. The Company and Penwest timely filed lawsuits against Barr in the United States District Court for the District of Delaware in connection with Barr's ANDA.

On April 12, 2010, the Company and Penwest settled all of the Barr litigation relating to Opana® ER. Under the terms of the settlement, Barr agreed not to challenge the validity or enforceability of Penwest's patents relating to Opana® ER. The Company and Penwest agreed to grant Barr a license permitting the production and sale of all strengths of Opana® ER commencing on September 15, 2012, or earlier under certain circumstances.

On January 20, 2010, the Company received a notice from Watson Laboratories, Inc. (Watson) advising of the filing by Watson of an ANDA containing a Paragraph IV certification under 21 U.S.C. section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in a 40 mg dosage strength. On March 19, 2010, the Company received a notice from Watson advising of the filing by Watson of an ANDA containing a Paragraph IV certification under 21 U.S.C. section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in 5, 7.5, 10, 15, 20, and 30 mg dosage strengths. The Company and Penwest timely filed lawsuits against Watson in the U.S. District Court for the District of New Jersey in connection with Watson's ANDA. The lawsuit alleges infringement of an Orange Book-listed U.S. patent that covers the Opana® ER formulation.

On October 4, 2010, the Company and Penwest settled all of the Watson litigation relating to Opana® ER. Under the terms of the settlement, Watson agreed not to challenge the validity or enforceability of Penwest's patents relating to Opana® ER. The Company and Penwest agreed to grant Watson a license permitting the production and sale of all strengths of Opana® ER commencing on September 15, 2012, or earlier under certain circumstances.

On December 29, 2009, the Company received a notice from Roxane Laboratories, Inc. (Roxane) advising of the filing by Roxane of an ANDA containing a Paragraph IV certification under 21 U.S.C. section 355(j) with respect to oxymorphone hydrochloride extended-release oral tablets in a 40 mg dosage strength. The notice refers to Penwest's U.S. Patent Nos. 5,662,933, 5,958,456 and 7,276,250, which cover the formulation of Opana® ER. These patents are listed in the FDA's Orange Book and expire in 2013, 2013, and 2023, respectively. Subsequently, on January 29, 2010, the Company and Penwest filed a lawsuit against Roxane in the U.S. District Court for the District of New Jersey in connection with Roxane's ANDA. The lawsuit alleges infringement of an Orange Book-listed U.S. patent that covers the Opana® ER formulation. Because the suit was filed within the 45-day period under the Hatch-Waxman Act for filing a patent infringement action, we believe that it triggered an automatic 30-month stay of approval under the Act.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

We intend to pursue all available legal and regulatory avenues in defense of Opana® ER, including enforcement of our intellectual property rights and approved labeling. However, there can be no assurance that we will be successful. Additionally, we cannot predict or determine the timing or outcome of any of these litigations but will explore all options as appropriate in the best interests of the Company.

## **Table of Contents**

### *Paragraph IV Certifications on Sanctura XR®*

On June 2, 2009, the Company's subsidiary, Endo Pharmaceuticals Solutions, Inc. (Endo Solutions), received a notice from Watson advising that Watson had filed a certification with the FDA under 21 C.F.R. Section 314.95(c)(1) in conjunction with ANDA 91-289 for approval to commercially manufacture and sell generic versions of Sanctura XR® trospium chloride extended release capsules. The Paragraph IV Certification Notice alleged that U.S. Patent No. 7,410,978, listed in the Orange Book for Sanctura XR® is invalid and/or will not be infringed by the commercial manufacture, use, or sale of Watson's generic product. This patent expires February 1, 2025 and is owned by Supernus Pharmaceuticals, Inc. and licensed to Endo Solutions.

In response to Watson's notice letter, on July 13, 2009, Endo Solutions and its partners Supernus Pharmaceuticals, Inc. (Supernus) and Allergan filed a lawsuit against Watson in the United States District Court for the District of Delaware alleging infringement of U.S. Patent No. 7,410,978 by Watson's ANDA. Because the suit was filed within the 45-day period under the Hatch-Waxman Act for filing a patent infringement action, we believe that it triggered an automatic 30-month stay of approval under the Act. We intend, and have been advised by Supernus and Allergan that they too intend, to contest this case vigorously. However, there can be no assurance that we will be successful. Additionally, we cannot predict or determine the timing or outcome of this litigation but will explore all options as appropriate in the best interests of the Company.

On November 4, 2009, the Company received a Paragraph IV Certification Notice under 21 U.S.C. Section 355(j) from Sandoz advising the Company that Sandoz had filed an ANDA for a generic version of Sanctura XR® trospium chloride extended release capsules. The Paragraph IV Certification Notice alleges that U.S. Patent No. 7,410,978, listed in the Orange Book for Sanctura XR® is invalid, unenforceable, and/or will not be infringed by the commercial manufacture, use, or sale of Sandoz's generic product. This patent expires February 1, 2025 and is owned by Supernus Pharmaceuticals, Inc. and licensed to Endo Solutions.

In response to Sandoz's Certification Notice, on November 19, 2009, Supernus, Endo Solutions and Allergan filed a lawsuit against Sandoz in the United States District Court for the District of Delaware alleging infringement of U.S. Patent No. 7,410,978 by Sandoz's ANDA. Because the suit was filed within the 45-day period under the Hatch-Waxman Act for filing a patent infringement action, we believe that it triggered an automatic 30-month stay of approval under the Act. We intend, and have been advised by Supernus and Allergan that they too intend, to contest this case vigorously. However, there can be no assurance that we will be successful. Additionally, we cannot predict or determine the timing or outcome of this litigation but will explore all options as appropriate in the best interests of the Company.

On April 26, 2010, the Company received a Paragraph IV Certification Notice under 21 U.S.C. Section 355(j) from Paddock Laboratories, Inc. (Paddock) advising the Company that Paddock had filed an ANDA for a generic version of Sanctura XR® trospium chloride extended release capsules. The Paragraph IV Certification Notice alleges that U.S. Patent No. 7,410,978, listed in the Orange Book for Sanctura XR® is invalid, unenforceable, and/or will not be infringed by the commercial manufacture, use, or sale of Paddock's generic product. This patent expires February 1, 2025 and is owned by Supernus Pharmaceuticals, Inc. and licensed to Endo Solutions.

In response to Paddock's Certification Notice, on June 9, 2010, Supernus, Endo Solutions and Allergan filed a lawsuit against Paddock in the United States District Court for the District of Delaware alleging infringement of U.S. Patent No. 7,410,978 by Paddock's ANDA. Because the suit was filed within the 45-day period under the Hatch-Waxman Act for filing a patent infringement action, we believe that it triggered an automatic 30-month stay of approval under the Act. We intend, and have been advised by Supernus and Allergan that they too intend, to contest this case vigorously. However, there can be no assurance that we will be successful. Additionally, we cannot predict or determine the timing or outcome of this litigation but will explore all options as appropriate in the best interests of the Company.

During the second half of 2010, Watson, Sandoz, and Paddock filed additional Paragraph IV certifications pertaining to U.S. Patent Nos. 7,763,635 (the 635 patent), 7,759,359 (the 359 patent), 7,781,448 (the 448 patent), and 7,781,449 (the 449 patent). In each case, Supernus, Allergan, and Endo Solutions filed complaints alleging infringement of the 448 and 449 patents by each defendant and infringement by Sandoz of the 635 and 359 patents as well.

On September 21, 2010, the court consolidated the suits against Sandoz and Paddock into the original suit filed against Watson. Trial in these cases is currently set to commence on May 2, 2011.

### *MCP Cases*

Qualitest, along with several other pharmaceutical manufacturers, has been named as a defendant in numerous lawsuits in various federal and state courts alleging personal injury resulting from the use of the prescription medicine metoclopramide. Plaintiffs in these suits allege various personal injuries including tardive dyskinesia, other movement disorders, and death. Trials in certain of these actions have been scheduled for 2011. Subject to certain terms and conditions, we will be indemnified by the former owners of Qualitest with respect to metoclopramide

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

litigation arising out of the sales of the product by Qualitest between January 1, 2006 and the date on which the acquisition was completed, subject to an overall liability cap of \$100 million for all claims arising out of or related to the acquisition, including the claims described above.

**Table of Contents***Propoxyphene Cases*

EPI and Qualitest, along with several other pharmaceutical manufacturers, have been named as defendants in several lawsuits in various federal and state courts alleging personal injury resulting from the use of the prescription medicine propoxyphene. Plaintiffs in these suits allege various personal injuries including cardiac impairment and damage. Certain plaintiffs seek to create a multidistrict litigation (MDL) with respect to cases filed in federal court. Subject to certain terms and conditions, we will be indemnified by the former owners of Qualitest with respect to propoxyphene litigation arising out of the sales of the product by Qualitest between January 1, 2006 and the date on which the acquisition was completed, subject to an overall liability cap of \$100 million for all claims arising out of or related to the acquisition, including the claims described above.

*Other Legal Proceedings*

In addition to the above proceedings, we are involved in, or have been involved in, arbitrations or various other legal proceedings that arise from the normal course of our business. We cannot predict the timing or outcome of these claims and other proceedings. Currently, we are not involved in any arbitration and/or other legal proceeding that we expect to have a material effect on our business, financial condition, results of operations and cash flows.

**NOTE 13. NET INCOME PER SHARE**

The following is a reconciliation of the numerator and denominator of basic and diluted net income per share (in thousands, except per share data):

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Numerator:</b>		
Net income attributable to Endo Pharmaceuticals Holdings Inc. common stockholders	\$ 55,787	\$ 60,355
<b>Denominator:</b>		
For basic per share data weighted average shares	116,354	117,347
Dilutive effect of common stock equivalents	2,269	684
Dilutive effect of 1.75% Convertible Senior Subordinated Notes	2,138	
<b>For diluted per share data weighted average shares</b>	<b>120,761</b>	<b>118,031</b>
Basic net income per share attributable to Endo Pharmaceuticals Holdings Inc	\$ 0.48	\$ 0.51
<b>Diluted net income per share attributable to Endo Pharmaceuticals Holdings Inc</b>	<b>\$ 0.46</b>	<b>\$ 0.51</b>

Basic net income per share is computed based on the weighted average number of common shares outstanding during the period. Diluted income per common share is computed based on the weighted average number of common shares outstanding and, if there is net income during the period, the dilutive impact of common stock equivalents outstanding during the period. Common stock equivalents are measured under the treasury stock method.

The 1.75% Convertible Senior Subordinated Notes due April 15, 2015 were only included in the dilutive net income per share calculation using the treasury stock method during periods in which the average market price of our common stock was above the applicable conversion price of the Convertible Notes, or \$29.20 per share. In these periods, under the treasury stock method, we calculated the number of shares issuable under the terms of these notes based on the average market price of the stock during the period, and included that number in the total diluted shares figure for the period.

We have entered into convertible note hedge and warrant agreements that, in combination, have the economic effect of reducing the dilutive impact of the Convertible Notes. However, we separately analyze the impact of the convertible note hedge and warrant agreements on diluted weighted average shares. As a result, the purchases of the convertible note hedges are excluded because their impact would be anti-dilutive. The



## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

treasury stock method will be applied when the warrants are in-the-money with the proceeds from the exercise of the warrant used to repurchase shares based on the average stock price in the calculation of diluted weighted average shares. Until the warrants are in-the-money, they have no impact to the diluted weighted average share calculation. The total number of shares that could potentially be included if the warrants were exercised is approximately 13 million.

The following reconciliation shows the shares excluded from the calculation of diluted net income per share as the inclusion of such shares would be anti-dilutive for the three months ended March 31 (in thousands):

	2011	2010
Weighted average shares excluded:		
1.75% Convertible senior subordinated notes due 2015 and warrants(1)	23,855	25,993
Employee stock-based awards	753	4,728
	24,608	30,721

**Table of Contents**

(1) Amounts represent the potential total dilution that could occur if our Convertible Notes and warrants were converted to shares of our common stock in excess of the amounts of related dilution included in our calculations of diluted net income per share.

**NOTE 14. COST OF REVENUES**

The components of cost of revenues for the three months ended March 31 (in thousands) were as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Cost of net pharmaceutical product sales	\$ 202,713	\$ 94,073
Cost of device, service and other revenues	28,845	
<b>Total cost of revenues</b>	<b>\$ 231,558</b>	<b>\$ 94,073</b>

**NOTE 15. DEBT**

The components of our total indebtedness at March 31, 2011 and December 31, 2010 (in thousands), were as follows:

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
7.00% Senior Notes due 2020	400,000	400,000
Unamortized initial purchaser's discount and debt issuance costs	(13,115)	(13,284)
<i>7.00% Senior Notes due 2020, net</i>	<i>\$ 386,885</i>	<i>\$ 386,716</i>
1.75% Convertible Senior Subordinated Notes due 2015	379,500	379,500
Unamortized discount on 1.75% Convertible Senior Subordinated Notes due 2015	(95,699)	(100,578)
<i>1.75% Convertible Senior Subordinated Notes due 2015, net</i>	<i>\$ 283,801</i>	<i>\$ 278,922</i>
<i>2010 Credit Facility, Term Loan due 2015, net</i>	<i>\$ 395,000</i>	<i>\$ 400,000</i>
<i>Other long-term debt, net</i>	<i>\$ 5,959</i>	<i>\$ 5,156</i>
<b>Total long-term debt, net</b>	<b>\$ 1,071,645</b>	<b>\$ 1,070,794</b>
Less current portion	\$ 27,525	\$ 24,993
<b>Total long-term debt, less current portion, net</b>	<b>\$ 1,044,120</b>	<b>\$ 1,045,801</b>

**Credit Facility**

In October 2009, we established a \$300 million, three-year senior secured revolving credit facility (the 2009 Credit Facility) with JP Morgan Chase Bank, Barclays Capital and certain other lenders. The 2009 Credit Facility was available for letters of credit, working capital and general corporate purposes. The 2009 Credit Facility also permitted up to \$100 million of additional revolving or term loan commitments from one or more of the existing lenders or other lenders.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Financing costs of \$5.2 million paid to establish the 2009 Credit Facility were deferred and were being amortized to interest expense over the life of the 2009 Credit Facility.

On November 30, 2010, we terminated the 2009 Credit Facility. Concurrent with the termination of the 2009 Credit Facility, we established a \$400 million, five-year senior secured term loan facility (the Term Loan Facility), and a \$500 million, five-year senior secured revolving credit facility (the Revolving Credit Facility and, together with the Term Loan Facility, the 2010 Credit Facility) with JP Morgan Chase Bank, Royal Bank of Canada, and certain other lenders. The 2010 Credit Facility was established primarily to finance our acquisition of Qualitest and is available for working capital and general corporate purposes. The agreement governing the 2010 Credit Facility (the 2010 Credit Agreement) also permits up to \$200 million of additional revolving or term loan commitments from one or more of the existing lenders or other lenders with the consent of the JP Morgan Chase Bank (the Administrative Agent) without the need for consent from any of the existing lenders under the 2010 Credit Facility.

The obligations of the Company under the 2010 Credit Facility are guaranteed by certain of the Company's domestic subsidiaries and are secured by substantially all of the assets of the Company and the subsidiary guarantors. The 2010 Credit Facility contains certain usual and customary covenants, including, but not limited to covenants to maintain maximum leverage and minimum interest coverage ratios. Borrowings under the 2010 Credit Facility will bear interest at an amount equal to a rate calculated based on the type of borrowing and the Company's Leverage Ratio. For term loans and revolving loans (other than Swing Line Loans), the Company may elect to pay interest based on an adjusted LIBOR rate plus between 2.00% and 2.75% or an Alternate Base Rate (as

**Table of Contents**

defined in the 2010 Credit Agreement) plus between 1.00% and 1.75%. The Company will also pay a commitment fee of between 35 to 50 basis points, payable quarterly, on the average daily unused amount of the Revolving Credit Facility. As of the date of this filing, the Company has not drawn any amounts under the 2010 Credit Facility.

Financing costs of \$16.5 million paid to establish the 2010 Credit Facility were deferred and are being amortized to interest expense over the life of the 2010 Credit Facility. Financing costs associated with the 2009 Credit Facility not yet amortized as of November 30, 2010 totaled approximately \$3.2 million on November 30, 2010. In accordance with the applicable accounting guidance for debt modifications, approximately \$0.3 million of this amount was written off in proportion to decreased lending capacity provided by certain individual loan syndicates with a corresponding charge to earnings. The remaining \$2.9 million was deferred and will be amortized over the life of the 2010 Credit Facility.

We recognized \$4.2 million and \$1.0 million of interest expense related to our 2010 Credit Facility and 2009 Credit Facility for the three months ended March 31, 2011 and March 31, 2010, respectively.

**7.00% Senior Notes Due 2020**

In November 2010, we issued \$400 million in aggregate principal amount of 7.00% Senior Notes due 2020 (the Senior Notes) at an issue price of 99.105%. The Senior Notes were issued in a private offering for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The Senior Notes are senior unsecured obligations of the Company and are guaranteed on a senior unsecured basis by certain of the Company's domestic subsidiaries. Interest on the Senior Notes is payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2011. The Senior Notes will mature on December 15, 2020, subject to earlier repurchase or redemption in accordance with the terms of the Indenture incorporated by reference herein. We received proceeds of approximately \$386.6 million from the issuance, net of the initial purchaser's discount and certain other costs of the offering.

On or after December 15, 2015, the Company may on any one or more occasions redeem all or a part of the Senior Notes, at the redemption prices (expressed as percentages of principal amount) set forth below, plus accrued and unpaid interest and additional interest, if any, if redeemed during the twelve-month period beginning on December 15 of the years indicated below:

<b>Payment Dates (between indicated dates)</b>	<b>Redemption Percentage</b>
From December 15, 2015 to and including December 14, 2016	103.500%
From December 15, 2016 to and including December 14, 2017	102.333%
From December 15, 2017 to and including December 14, 2018	101.167%
From December 15, 2018 and thereafter	100.000%

In addition, at any time prior to December 15, 2013, the Company may redeem up to 35% of the aggregate principal amount of the Senior Notes at a specified redemption price set forth in the Indenture, plus accrued and unpaid interest and additional interest, if any. If the Company experiences certain change of control events, it must offer to repurchase the Senior Notes at 101% of their principal amount, plus accrued and unpaid interest and additional interest, if any.

The Indenture contains covenants that, among other things, restrict the Company's ability and the ability of its restricted subsidiaries to incur certain additional indebtedness and issue preferred stock, make restricted payments, sell certain assets, agree to any restrictions on the ability of restricted subsidiaries to make payments to the Company, create certain liens, merge, consolidate, or sell substantially all of the Company's assets, or enter into certain transactions with affiliates. These covenants are subject to a number of important exceptions and qualifications, including the fall away or revision of certain of these covenants upon the Senior Notes receiving investment grade credit ratings.

We recognized \$7.2 million of interest expense related to our Senior Notes for the three months ended March 31, 2011.

**1.75% Convertible Senior Subordinated Notes Due 2015**

In April 2008, we issued \$379.5 million in aggregate principal amount of 1.75% Convertible Senior Subordinated Notes due April 15, 2015 (the Convertible Notes) in a private offering for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

We received proceeds of approximately \$370.7 million from the issuance, net of the initial purchaser's discount and certain other costs of the offering. Interest is payable semi-annually in arrears on each April 15 and October 15 with the first interest payment being made on October 15, 2008. The Convertible Notes will mature on April 15, 2015, unless earlier converted or repurchased by us.

Holder s of the Convertible Notes may convert their notes based on a conversion rate of 34.2466 shares of our common stock per \$1,000 principal amount of notes (the equivalent of \$29.20 per share), subject to adjustment upon certain events, only under the following circumstances as described in the Indenture for the Convertible Notes (the Indenture): (1) during specified periods, if the price of our common stock reaches specified thresholds; (2) if the trading price of the Convertible Notes is below a specified

**Table of Contents**

threshold; (3) at any time after October 15, 2014; or (4) upon the occurrence of certain corporate transactions. We will be permitted to deliver cash, shares of Endo common stock or a combination of cash and shares, at our election, to satisfy any future conversions of the Convertible Notes. It is our current intention to settle the principal amount of any conversion consideration in cash.

Concurrently with the issuance of the Convertible Notes, we entered into a privately negotiated convertible note hedge transaction with affiliates of the initial purchasers. Pursuant to the hedge transaction we purchased common stock call options intended to reduce the potential dilution to our common stock upon conversion of the Convertible Notes by effectively increasing the initial conversion price of the Convertible Notes to \$40.00 per share, representing a 61.1% conversion premium over the closing price of our common stock on April 9, 2008 of \$24.85 per share. The call options allow us to purchase up to approximately 13.0 million shares of our common stock at an initial strike price of \$29.20 per share. The call options expire on April 15, 2015 and must be net-share settled. The cost of the call option was approximately \$107.6 million. In addition, we sold warrants to affiliates of certain of the initial purchasers whereby they have the option to purchase up to approximately 13.0 million shares of our common stock at an initial strike price of \$40.00 per share. The warrants expire on various dates from July 14, 2015 through October 6, 2015 and must be net-share settled. We received approximately \$50.4 million in cash proceeds from the sale of these warrants. The warrant transaction could have a dilutive effect on our net income per share to the extent that the price of our common stock exceeds the strike price of the warrants at exercise.

As discussed in Note 13, in periods in which our common stock price exceeds the conversion price of the Convertible Notes or the strike price of the warrants, we include the effects of the additional shares that may be issued in our diluted net income per share calculation using the treasury stock method.

On January 1, 2009 the Company retrospectively adopted the provisions of the authoritative guidance relating to the accounting for convertible debt instruments. The guidance requires that issuers of convertible debt instruments that may be settled in cash or other assets on conversion to separately account for the liability and equity components of the instrument in a manner that will reflect the entity's nonconvertible debt borrowing rate on the instrument's issuance date when interest cost is recognized in subsequent periods.

As a result of our adoption, we separated the debt portion of our Convertible Notes from the equity portion at their fair value retrospective to the date of issuance and are amortizing the resulting discount into interest expense over the life of the Convertible Notes.

The carrying values of the debt and equity components of our Convertible Notes at March 31, 2011 and December 31, 2010 are as follows (in thousands):

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Principal amount of Convertible Notes	\$ 379,500	\$ 379,500
Unamortized discount related to the debt component(1)	(95,699)	(100,578)
<b>Net carrying amount of the debt component</b>	<b>\$ 283,801</b>	<b>\$ 278,922</b>
Carrying amount of the equity component	\$ 142,199	\$ 142,199

- (1) Represents the unamortized portion of the original purchaser's discount and certain other costs of the offering as well as the unamortized portion of the discount created from the separation of the debt portion of our Convertible Notes from the equity portion. This discount will be amortized to interest expense over the term of the Convertible Notes.

We recognized \$6.5 million and \$6.1 million of interest expense for the three months ended March 31, 2011 and March 31, 2010, respectively. For the amounts recognized in 2011, \$1.7 million related to the contractual interest payments and \$4.8 million related to the amortization of the debt discount and certain other costs of the offering. This compared to \$1.7 million of contractual interest payments and \$4.4 million related to the amortization of the debt discount and certain other costs of the offering for the three months ended March 31, 2010.

**Non-recourse Notes**

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

On August 26, 2008, Indevus closed a private placement to institutional investors of \$105.0 million in aggregate principal amount of 16% non-convertible, non-recourse, secured promissory notes due 2024 (Non-recourse Notes). The Non-recourse Notes were issued by Ledgemont Royalty Sub LLC (Royalty Sub), which was a wholly-owned subsidiary of Indevus at the time of the Non-recourse Note issuance and subsequently became a wholly-owned subsidiary of the Company upon our acquisition of Indevus. As of the Indevus Acquisition Date, the Company recorded these notes at their fair value of approximately \$115.2 million and began amortizing these notes to their face value of \$105.0 million at maturity in 2024.

In August 2009, the Company commenced a cash tender offer for any and all outstanding Non-recourse notes. The purpose of the tender offer was to acquire any and all Notes to reduce our consolidated interest expense. The tender offer included an early tender deadline, whereby holders of the Non-recourse Notes could early tender and receive the total early consideration of \$1,000 per \$1,000 principal amount of the Non-recourse notes. Holders who tendered their Non-recourse Notes after such time and at or prior to the expiration of the tender offer period were eligible to receive the tender offer consideration of \$950 per \$1,000 principal amount of

**Table of Contents**

Non-recourse notes, which was the total early consideration less the early tender payment. The tender offer expired on September 24, 2009, at 5:00 p.m., New York City time (the Expiration Time). As of the Expiration Time, \$48 million in Non-recourse Notes had been validly tendered and not withdrawn. The Company accepted for payment and purchased Non-recourse Notes at a purchase price of \$1,000 per \$1,000 principal amount, for a total amount of approximately \$48 million (excluding accrued and unpaid interest up to, but not including, the payment date for the Non-recourse Notes, fees and other expenses in connection with the tender offer). The aggregate principal amount of Non-recourse Notes purchased represents approximately 46% of the \$105 million aggregate principal amount of Non-recourse Notes that were outstanding prior to the Expiration Time. Accordingly, the Company recorded a \$4.0 million gain on the extinguishment of debt, net of transaction costs. The gain was calculated as the difference between the aggregate amount paid to purchase the Non-recourse Notes and their carrying amount.

During the third quarter of 2010, Endo notified the holders of its intent to exercise its option to redeem the remaining \$57 million of principal at 108% of the principal amount for approximately \$62 million (amount excludes accrued and unpaid interest) on November 5, 2010. The Non-recourse Notes were redeemed in November 2010.

**NOTE 16. SUBSEQUENT EVENTS**

On April 10, 2011, Endo, NIKA Merger Sub, Inc., an indirect wholly owned subsidiary of Endo (Merger Sub) and American Medical Systems Holdings, Inc. (AMS) entered into an agreement and plan of merger (the AMS Merger Agreement). Pursuant to the AMS Merger Agreement, Endo will acquire all of the outstanding stock of AMS for a purchase price of \$30.00 per share in cash, without interest (the AMS Merger Consideration), and Merger Sub will merge with and into AMS (the AMS Merger) with AMS continuing as the surviving corporation and an indirect wholly owned subsidiary of Endo. The completion of the AMS Merger is subject to customary conditions, including the approval of AMS stockholders, the absence of any material adverse effect on AMS business and receiving certain antitrust approvals (including under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended). The merger is expected to close in the third quarter.

Pursuant to the AMS Merger Agreement, each issued and outstanding share of AMS common stock will be converted into the right to receive the AMS Merger Consideration. Each option to acquire AMS common stock which is vested and exercisable immediately prior to the AMS Merger will be canceled and terminated in exchange for the right to receive the AMS Merger Consideration minus the exercise price per share of the option. All other options will be converted into options to acquire Endo common stock on comparable economic terms and conditions as were applicable to such options immediately prior to the AMS Merger. Each issued and outstanding share of restricted AMS common stock that is subject to vesting restrictions that would vest within one year of the closing of the AMS Merger will be converted into the right to receive the AMS Merger Consideration. All other restricted AMS common stock subject to vesting restrictions will be converted into restricted shares of Endo common stock with comparable economic terms and conditions as were applicable to such restricted AMS shares immediately prior to the AMS Merger.

The AMS Merger Agreement contains customary representations, warranties, termination provisions, and covenants by AMS and Endo. In connection with the Merger, Endo has entered into financing commitments with Morgan Stanley and Bank of America Merrill Lynch. Morgan Stanley and Bank of America Merrill Lynch have also backstopped the Company's current \$500 million revolving credit facility. The Company currently expects to close the transaction with cash on hand, up to \$2.4 billion in term loans, and about \$700 million in bonds. Between now and closing, however, the Company will continue to explore opportunities to further optimize its capital structure. Funding is contingent on the closing of the Merger and certain other conditions; financing is not a condition to the obligations of Endo or Merger Sub under the terms of the Merger Agreement.

The AMS Merger Agreement may be terminated under certain circumstances, including by Endo (i) if the AMS Board withdraws, fails to reaffirm, or changes its recommendation in support of the AMS Merger or fails to reject certain alternative transaction proposals within specified periods of time, or (ii) if AMS fails to hold a stockholders' meeting to vote on the AMS Merger or fails to include the AMS Board's recommendation in support of the AMS Merger in the proxy statement. AMS may terminate the AMS Merger Agreement prior to its adoption by AMS stockholders in the event that AMS receives an unsolicited proposal that AMS concludes, after following certain procedures, is a Superior Proposal (as defined in the AMS Merger Agreement). In each of these cases, AMS may be required to pay Endo a termination fee of \$90 million (the Termination Fee). In addition, if either party terminates the AMS Merger Agreement (i) under certain circumstances described in the AMS Merger Agreement and an Acquisition Proposal (as defined in the AMS Merger Agreement) is public at or prior to the time of such termination and (ii) AMS enters into an agreement to consummate, or actually consummates, certain alternative transactions within twelve (12) months after such termination, then AMS may be required to pay Endo up to \$45 million of its transaction costs (Endo Transaction Costs) at the time of the termination, and the Termination Fee less the Endo Transaction Costs at the time such agreement is entered into or consummated.

In connection with the Merger, Endo has entered into a commitment (the Commitment Letter) pursuant to which Morgan Stanley Senior Funding, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Bank of America, N.A. have, among other things, agreed to (i) structure, arrange and syndicate a bridge loan facility to Endo in an aggregate principal amount of \$700 million, (ii) arrange a senior secured term loan. A



## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

facility in an aggregate principal amount of \$1.5 billion, (iii) arrange a senior secured term loan B facility in an aggregate principal amount of \$900 million and (iv) arrange a multicurrency revolving credit facility in an initial aggregate principal amount of \$500 million (collectively, the Debt Financing). The funding of the Debt Financing is contingent on the closing of the Merger and certain other conditions set forth in the Commitment Letter. The funding of the Debt Financing is not a condition to the obligations of Endo or Merger Sub under the terms of the Merger Agreement.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations describes the principal factors affecting the results of operations, liquidity and capital resources, and critical accounting estimates of Endo. This discussion should be read in conjunction with the accompanying quarterly unaudited Condensed Consolidated Financial Statements and our Annual Report on Form 10-K, for the year ended December 31, 2010 (Annual Report). Our Annual Report includes additional information about our significant accounting policies, practices and the transactions that underlie our financial results, as well as a detailed discussion of the most significant risks and uncertainties associated with our financial and operating results. Except for the historical information contained in this Report, this Report, including the following discussion, contains forward-looking statements that involve risks and uncertainties. See *Forward-Looking Statements* beginning on page i of this Report.

**EXECUTIVE SUMMARY***About the Company*

Endo Pharmaceuticals Holdings Inc., which we refer to as *Endo*, *we*, *us*, or the *Company*, is a United States-based, specialty healthcare solution company focused on branded products and generics, and devices and services. Endo is redefining its position in the healthcare marketplace by anticipating and embracing the evolution of health decisions based on the need for high-quality and cost-effective care. We aim to be the premier partner to healthcare professionals and payment providers, delivering an innovative suite of complementary branded and generic drugs, devices, services and clinical data to meet the needs of patients in areas such as pain management, urology, oncology and endocrinology. Most recently, we have moved in this direction through our acquisition of Qualitest, which expands and diversifies our generic drug product offerings and enhances our pain management portfolio, and through our acquisition of HealthTronics, which has expanded and diversified our reach as a provider of healthcare services and medical devices and our presence in urology.

We have a portfolio of branded pharmaceuticals that includes established brand names such as Lidoderm<sup>®</sup>, Opana<sup>®</sup> ER and Opana<sup>®</sup>, Percocet<sup>®</sup>, Frova<sup>®</sup>, Voltaren<sup>®</sup> Gel, Vantas<sup>®</sup>, Valstar<sup>®</sup>, and Supprelin<sup>®</sup> LA. Branded products comprised approximately 67% of our revenues in the three months ended March 31, 2011, with 34% of our revenues coming from Lidoderm<sup>®</sup>. Our non-branded generic portfolio, which accounted for 24% of revenues in the three months ended March 31, 2011, currently consists of products primarily focused in pain management. We focus on selective generics that have one or more barriers to market entry, such as complex formulation, regulatory or legal challenges or difficulty in raw material sourcing. Revenue from our devices and services portfolio accounted for the remainder of our revenues for the three months ended March 31, 2011. We generated total revenues of \$560.0 million for the three months ended March 31, 2011.

On April 10, 2011, Endo, NIKA Merger Sub, Inc., an indirect wholly owned subsidiary of Endo and AMS entered into the AMS Merger Agreement, which is discussed in further detail in the Liquidity and Capital Resources section below. The merger is expected to close in the third quarter of 2011. AMS is a market leading provider of medical devices and therapies that help restore pelvic health, and is recognized as a technology leader for developing minimally invasive and more cost effective solutions, serving urologists, urogynecologists, and gynecologists.

In November 2010, we acquired Qualitest, a leading United States based privately-held generics company. As a combined company, we expect to deliver more comprehensive healthcare solutions across our diversified businesses in Branded Pharmaceuticals, Generics, and Devices and Services in key therapeutic areas including pain and urology. Qualitest, the sixth largest U.S. generics company, as measured by prescriptions filled in the year ended December 31, 2010, is focused on cost-competitive, high-quality manufactured products with cost advantages or with high barriers to entry. We believe Qualitest brings critical mass to our current generics business, further diversifies our business lines and product offerings and enhances our portfolio of pain management products.

In July 2010, we completed our acquisition of HealthTronics, a provider of healthcare services and manufacturer of medical devices, primarily for the urology community. In September 2010, we acquired Penwest, a drug development company.

Financial information presented herein reflects the operating results of HealthTronics, Penwest, and Qualitest from January 1, 2011.

We have dedicated sales forces in the United States, consisting of 500 Endo pharmaceutical sales representatives and 228 sales contracted representatives focusing primarily on pain products, 83 Endo sales representatives focusing primarily on bladder and prostate cancer products, 35 Endo medical center representatives focusing on the treatment of central precocious puberty and 56 Endo account executives focusing on managed markets customers. We market our branded pharmaceuticals to primary care physicians and specialty physicians, including those specializing in pain management, orthopedics, neurology, rheumatology, surgery, anesthesiology, urology and pediatric endocrinology. Our sales force also targets retail pharmacies and other healthcare professionals throughout the United States.

*Changes in Directors & Officers and Other Related Matters*

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

On March 3, 2011, the Registrant increased the size of its Board of Directors from eight to nine and appointed David B. Nash, M.D., M.B.A. to fill this new vacancy. Dr. Nash is the founding dean of the Jefferson School of Population Health, located on the campus of Thomas Jefferson University in Philadelphia, Pennsylvania, having taken that position in 2008. Previously, Dr. Nash was the Chairman of the Department of Health Policy of the Jefferson Medical College from 2003 to 2008. Dr. Nash is internationally

---

**Table of Contents**

recognized for his work in outcomes management, medical staff development and quality-of-care improvement; his publications have appeared in more than 100 articles in major journals. Dr. Nash serves on the Board of Directors of Humana Inc., one of the nation's largest publicly traded health and supplemental benefits companies, offering a wide array of health, pharmacy and supplemental benefit plans for employer groups, government programs and individuals, as well as primary and workplace care through its more than 300 medical centers and 240 worksite medical facilities. Dr. Nash also has served as a member of the Board of Trustees of Catholic Healthcare Partners in Cincinnati, Ohio. The Board believes that Dr. Nash brings a unique and value-added set of attributes that enhance the Company's ability to help people achieve lifelong well-being. Dr. Nash is a widely recognized innovator in an emerging medical discipline that unites population health, health policy, and individual health.

***Healthcare Reform***

On March 23, 2010, President Obama signed into law H.R. 3590, the Patient Protection and Affordable Care Act (PPACA), which will make major changes to the U.S. healthcare system. On March 30, 2010, the President signed H.R. 4872, the Health Care and Education Reconciliation Act of 2010 (Reconciliation Act), which included a package of changes to the PPACA, as well as additional elements to reform health care in the United States.

While some provisions of the new healthcare reform law go into effect this year, most of the provisions will not begin to be implemented until 2014 and beyond. Since implementation will be incremental to the enactment date of the law, there are still many challenges and uncertainties ahead. Such a comprehensive reform measure may require expanded implementation efforts on the part of federal and state agencies embarking on rule-making to develop the specific components of their new authority. The Company will monitor closely the implementation of the new law. In addition, the Company will continue to monitor attempts to repeal, replace, or defund the U.S. Health Reform Law. This effort will primarily take place on two fronts: 1) in Congress through attempts to pass legislation to overturn all or specific sections of the law and 2) in the Courts through attempts to have the law declared unconstitutional.

The passage of the PPACA and the Reconciliation Act will result in a transformation of the delivery and payment for health care services in the U.S. The combination of these measures will expand health insurance coverage to an estimated 32 million Americans. In addition, there are significant health insurance reforms that are expected to improve patients' ability to obtain and maintain health insurance. Such measures include: the elimination of lifetime caps; no rescission of policies; and no denial of coverage due to preexisting conditions. The expansion of healthcare insurance and these additional market reforms should result in greater access to the Company's products.

Our estimate of the overall impact of healthcare reform reflects a number of uncertainties. However, we believe that the 2011 impact to our business will be largely attributable to changes in the Medicare Part D Coverage Gap, Medicaid Fee-For-Service Program and Medicaid Managed Care plans. There are a number of other provisions in the legislation that collectively are expected to have a small impact, including originator average manufacturers' price (AMP) for new formulations, the expansion of 340B pricing and the revision of the AMP definition (effective October 1, 2010) to remove physician class of trade. In addition, we expect the increase in the minimum Medicaid rebate in 2010 to impact 2011 Managed Care discounts as Managed Care Organizations look to increase their rebates on certain products where possible. These various elements of healthcare reform are expected to adversely impact total revenues by approximately \$40 million in 2011 compared to approximately \$20 million in 2010.

In the United States, the Medicare Prescription Drug Improvement and Modernization Act of 2003 continues to provide an effective prescription drug benefit to seniors and individuals with disabilities in the Medicare program (Medicare Part D). Currently, uncertainty exists due to the healthcare reform legislation currently being considered by Congress. While these proposals have the potential to increase the number of U.S. residents with access to health care services, they also have the potential to impose new costs and increase pricing pressures on the pharmaceutical industry. Virtually all of the proposals seek to reduce significantly the number of uninsured Americans through a combination of private insurance market reforms, mandates on individuals to have health insurance coverage, and premium subsidies to individuals to assist in the purchase of healthcare insurance. Upon obtaining healthcare coverage, previously uninsured individuals are likely to consume more healthcare services, including pharmaceutical products. However, many of the legislative proposals being debated by Congress seek cost savings through additional pricing pressures on prescription products. For example, one proposal being considered would require the Secretary of Health and Human Services to negotiate Medicare Part D prescription drug prices directly with pharmaceutical manufacturers in order to leverage greater savings. Further, proposals to expand coverage to the uninsured may be financed through increased rebates or the imposition of a tax on the pharmaceutical industry. In addition to the federal debate on health care reform, many states are facing substantial budget difficulties due to the downturn in the economy and are expected to seek aggressive cuts or other offsets in healthcare spending. Accordingly, we expect pricing pressures at the federal and state levels to intensify, which could have a material effect on the consolidated results of operations, cash flows and/or financial position.

***FDA Advisory Committee***

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

The FDA held a public advisory committee meeting in June 2009 to discuss acetaminophen use in both over-the-counter (OTC) and prescription (Rx) products, the potential for liver injury, and potential interventions to reduce the incidence of liver injury. The panel's recommendations followed the release in May 2009 of an FDA report that found severe liver damage, and even death, can result from a lack of consumer awareness that acetaminophen can cause such injury. These recommendations were advisory in nature and the FDA was not bound to follow these recommendations.

## **Table of Contents**

On January 14, 2011, the FDA announced in the Federal Register that it was taking steps to reduce the maximum amount of acetaminophen in prescription drug products, to help reduce or prevent the risk of liver injury from an unintentional overdose of acetaminophen. A variety of combination drug products include acetaminophen, such as those that contain the opioids oxycodone hydrochloride or hydrocodone bitartrate and acetaminophen, among others. Under additional authority granted to the FDA by the Food and Drug Administration Amendments Act of 2007, the FDA notified holders of approved NDA's and ANDAs that they would be required to modify the labeling of prescription acetaminophen drug products to reflect new safety information about acetaminophen and liver toxicity. The FDA also announced that it was asking product sponsors to limit the maximum strength of acetaminophen per unit of the combination drug products to 325 mg over a three-year phase-out period. At the end of that period, the FDA could seek to withdraw those products that contain more than 325 mg of acetaminophen from the market. Among the products impacted by the FDA's action are three Endo combination drug pain relief products: Percocet, Endocet and Zydone. These regulatory changes, or others required by the FDA, could have an adverse effect on our business, financial condition, results of operations, and cash flows.

### ***Pipeline Developments***

In February 2011, the FDA requested that additional pre-clinical studies, including a carcinogenicity study, be completed prior to the submission of the NDA for the octreotide implant for the treatment of acromegaly. Although this development causes a delay of up to four years in the timing associated with regulatory approval, the Company intends to continue the development of this product and is encouraged by recent preliminary results from its Phase III study.

In addition, the Company recently assessed all of its in-process research and development assets and concluded, separately, to discontinue development of its octreotide implant for the treatment of carcinoid syndrome due to recent market research that indicates certain commercial challenges, including the expected rate of physician acceptance and the expected rate of existing patients willing to switch therapies.

In January 2011, the Company entered into a Discovery, Development and Commercialization Agreement (the 2011 Orion Agreement) with Orion Corporation (Orion) to exclusively co-develop products for the treatment of certain cancers and solid tumors. In January 2011, Endo exercised its option to obtain a license to jointly develop and commercialize Orion's Anti-Androgen program focused on castration-resistant prostate cancer, one of Orion's four contributed research programs, and made a corresponding payment to Orion for \$10 million, which was expensed in the first quarter of 2011.

In July 2010, we filed an NDA with the FDA for a new extended-release formulation of oxymorphone, which is a semi-synthetic opioid analgesic intended for the treatment of moderate to severe chronic pain in patients requiring continuous, around-the-clock opioid treatment for an extended period of time. The NDA submission is based on a non-clinical and clinical development program designed to demonstrate the crush-resistant properties of this formulation of oxymorphone. In January 2011, we received a complete response letter from the FDA. The FDA issues complete response letters to communicate that its initial review of an NDA or ANDA is complete and that the application cannot be approved in its present form. A complete response also informs applicants of changes that must be made before an application can be approved, with no implication regarding the ultimate approvability of the application. The letter did not require that additional clinical studies be conducted for approval of the NDA. We have begun to address the issue described in the complete response letter and will work closely with the FDA to finalize our response. We are confident that we can address the issue set forth, currently anticipate responding to the FDA by mid-2011 and would expect a six month review cycle once our response is filed.

On December 2, 2009, we received a complete response letter from the FDA regarding Aveed<sup>TM</sup>. In the complete response letter, the FDA has requested information from Endo to address the agency's concerns regarding very rare but serious adverse events, including post-injection anaphylactic reaction and pulmonary oily microembolism. The letter also specified that the proposed risk evaluation and mitigation strategy (REMS) is not sufficient. We continue to evaluate how best to address the concerns of the FDA and intend to have future additional dialogue with the agency regarding a possible regulatory pathway.

### ***Branded Business Activity***

In December 2010, the FDA approved Fortesta<sup>TM</sup> Gel for the treatment of Low T, also known as hypogonadism. Endo introduced Fortesta<sup>TM</sup> Gel in the United States during the first quarter of 2011. As of March 31, 2011, we have deferred the recognition of approximately \$9 million of gross sales of Fortesta<sup>TM</sup> Gel.

## **RESULTS OF OPERATIONS**

Our quarterly results have fluctuated in the past, and may continue to fluctuate. These fluctuations are primarily due to (1) the timing of mergers, acquisitions and other business development activity, (2) the timing of new product launches, (3) purchasing patterns of our customers,

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

(4) market acceptance of our products, (5) the impact of competitive products and products we recently acquired and (6) pricing. These fluctuations are also attributable to charges incurred for compensation related to stock compensation, amortization of intangible assets, impairment of intangible assets, and certain upfront, milestone and certain other payments made or accrued pursuant to acquisition or licensing agreements.

**Table of Contents****Consolidated Results Review**

**Revenues.** Revenues for the three months ended March 31, 2011 increased 54% to \$560.0 million from \$364.4 million in the comparable 2010 period. This increase in revenues is primarily driven by organic growth in our branded pharmaceuticals product portfolio, including Lidoderm<sup>®</sup>, Opana<sup>®</sup> ER, and Voltaren<sup>®</sup> Gel, as well as incremental revenues from our 2010 acquisitions, including \$50.1 million in revenues from HealthTronics and \$106.4 million in revenues from Qualitest, which we acquired during the second and fourth quarters of 2010, respectively. For the three months ended March 31, 2011, sales growth was essentially volume driven, while price fluctuations had no material impact.

The following table displays our revenues by category and as a percentage of total revenues for the three months ended March 31, 2011 and 2010 (dollars in thousands). Certain prior year amounts have been reclassified to conform to the current year presentation:

	Three Months Ended March 31,		Three Months Ended March 31,	
	2011	%	2010	%
Lidoderm <sup>®</sup>	\$ 189,725	34	\$ 182,607	50
Opana <sup>®</sup> ER and Opana <sup>®</sup>	89,072	16	66,157	18
Voltaren <sup>®</sup> Gel	31,298	6	20,362	6
Percocet <sup>®</sup>	26,960	5	28,673	8
Frova <sup>®</sup>	13,208	2	15,082	4
Supprelin <sup>®</sup> LA	11,222	2	10,587	3
Other brands	14,029	3	15,068	4
Total brands*	375,514	67	338,536	93
Total generics	134,409	24	25,876	7
Total devices and service revenue	50,103	9		
<b>Total revenues</b>	<b>\$ 560,026</b>	<b>100</b>	<b>\$ 364,412</b>	<b>100</b>

\* Percentages may not add due to rounding.

**Lidoderm<sup>®</sup>.** Net sales of Lidoderm<sup>®</sup> for the three months ended March 31, 2011 increased by \$7.1 million, or 4%, from the comparable 2010 period. During the first quarter of 2011, the increase in Lidoderm<sup>®</sup> is primarily attributable to increased volumes compared to the same period in 2010, partially offset by price decreases resulting from higher rebates to managed care organizations.

**Opana<sup>®</sup> ER and Opana<sup>®</sup>.** Net Sales of Opana<sup>®</sup> ER and Opana<sup>®</sup> for the three months ended March 31, 2011 increased by \$22.9 million, or 35% from the comparable 2010 period. The growth in net sales is primarily attributable to continued prescription and market share growth of the products, as we continue to drive our promotional efforts through physician targeting. In addition, our strategy to aggressively contract with managed care organizations has resulted in increases in volume as we have broadened our access for the brand.

**Voltaren<sup>®</sup> Gel.** Net sales of Voltaren<sup>®</sup> Gel for the three months ended March 31, 2011 increased by \$10.9 million or 54% from the comparable 2010 period. The Company launched Voltaren<sup>®</sup> Gel in March 2008 and we believe the growth of Voltaren<sup>®</sup> Gel since its launch is driven by the product's proven clinical efficacy combined with our continued promotional activities aimed at increasing product awareness in the target audience.

**Percocet<sup>®</sup>.** Net sales of Percocet<sup>®</sup> for the three months ended March 31, 2011 decreased by \$1.7 million, or 6% from the comparable 2010 period. The decrease is primarily attributable to reduced volumes during the first quarter of 2011 as compared to 2010.

**Frova<sup>®</sup>.** Net sales of Frova<sup>®</sup> for the quarter ended March 31, 2011 decreased by \$1.9 million or 12% from the comparable 2010 period. The decrease is primarily attributable to reduced volumes during the first quarter of 2011 as compared to 2010.

**Supprelin<sup>®</sup> LA.** Net sales of Supprelin<sup>®</sup> LA for the three months ended March 31, 2011 increased by \$0.6 million or 6% from the comparable 2010 period. This increase was driven by volume growth during the first quarter of 2011, resulting primarily from an increase in new patient



## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

starts and a growing base of continued care patients. We believe this growth is largely due to a strong base of national opinion leader support and ongoing efforts to streamline the treatment initiation process.

*Other brands.* Net sales of our other branded products for the three months ended March 31, 2011 decreased by \$1.0 million from the comparable 2010 period. This decrease is largely attributable to decreased revenues from Vantas<sup>®</sup> and certain of our other branded products, partially offset by increased revenues from Valstar<sup>®</sup>.

*Generics.* Net sales of our generic products for the three months ended March 31, 2011 increased by \$108.5 million, or 419% from the comparable 2010 period. This increase was largely attributable to our acquisition of Qualitest on November 30, 2010, which contributed \$106.4 million of net sales of generic products during the three months ended March 31, 2011.

**Table of Contents**

**Gross Margin, Costs and Expenses.** The following table sets forth costs and expenses for the three months ended March 31, 2011 and 2010:

	2011	March 31, % of revenues (in thousands)	2010	% of revenues
Cost of revenues	\$ 231,558	41%	\$ 94,073	26%
Selling, general and administrative	159,386	28%	133,335	37%
Research and development	42,130	8%	29,168	8%
Acquisition related costs	6,073	1%	1,529	*
<b>Total costs and expenses</b>	<b>\$ 439,147</b>	<b>78%</b>	<b>\$ 258,105</b>	<b>71%</b>

\* Amount less than 1%.

**Cost of Revenues and Gross Margin.** Cost of revenues for the three months ended March 31, 2011 increased by \$137.5 million or 146%, to \$231.6 million from \$94.1 million in the comparable 2010 period. This increase was primarily driven by our second half 2010 acquisitions which, on a combined basis, contributed approximately \$133.8 million to our cost of revenues during the three months ended March 31, 2011. The remaining \$3.7 million of this increase relates to increased sales of our legacy Endo products. Gross profit margins for the three months ended March 31, 2011 and 2010 were 59% and 74%, respectively. The reduction in gross profit margins is primarily due to the acquisitions of HealthTronics and Qualitest, which contributed a lower gross profit margin percentage than Endo's legacy products. Gross profit margin has also been unfavorably impacted by the increased amortization expense during the three months ended March 31, 2011 compared to the comparable 2010 period as a result of our recent acquisitions.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses for the three months ended March 31, 2011 increased to \$159.4 million from \$133.3 million in the comparable 2010 period. The increase in Selling, general and administrative expenses for the three months ended March 31, 2011 compared to 2010 is primarily attributable to increased expenses as a result of our second half 2010 acquisitions of \$21.6 million as well as \$3.5 million of certain costs incurred in connection with continued efforts to enhance the cost structure of the Company.

**Research and Development Expenses.** Research and development expenses for the three months ended March 31, 2011 increased to \$42.1 million from \$29.2 million in the comparable 2010 period. This increase was primarily driven by the addition of Qualitest's research and development portfolio to our existing programs, the progress of our branded pharmaceutical portfolio's development, and the expansion of our efforts in the pharmaceutical discovery and device research and development areas. Additionally, during the three months ended March 31, 2011, we incurred \$11.0 million in expense related to milestones compared to \$3.0 million in the comparable 2010 period.

**Acquisition Related Items.** Acquisition-related items for the three months ended March 31, 2011 were \$6.1 million in expense compared to \$1.5 million in expense in the comparable 2010 period. Acquisition-related items for the three months ended March 31, 2011 primarily consisted of transaction fees of \$6.8 million, including legal, separation, integration, and other expenses for our recent and pending acquisitions, partially offset by favorable changes in the fair value of the acquisition-related contingent consideration of \$0.7 million, which was recorded as a gain. The change in the fair value of the acquisition-related contingent consideration primarily reflects changes of our present value assumptions associated with our valuation models. This compares to \$1.5 million in expense in the comparable 2010 period resulting from changes in the fair value of the acquisition-related contingent consideration and other miscellaneous integration costs associated with our 2009 acquisition of Indevus.

**Interest Expense, net.** The components of interest expense (income), net at March 31, 2011 and 2010 are as follows (in thousands):

	2011	2010
Interest expense	\$ 18,917	\$ 10,228
Interest income	(127)	(424)

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Interest expense, net	\$ 18,790	\$ 9,804
-----------------------	-----------	----------

Interest expense for the three months ended March 31, 2011 increased to \$18.9 million from \$10.2 million in the comparable 2010 period. This increase is primarily due to \$11.4 million of interest expense resulting from the \$800 million of indebtedness the Company incurred in November of 2010, partially offset by decreases in interest related to our early retirement of both the 2009 Credit Facility and the Non-recourse Notes. Interest income decreased to \$0.1 million for the three months ended March 31, 2011 compared to \$0.4 million in the comparable 2010 period. This decrease is a result of the fluctuations in the amount of cash invested in interest-bearing accounts, including our money market funds and auction-rate securities and the yields on those investments.

**Table of Contents**

**Other Expense (Income), net.** The components of Other expense (income), net at March 31, 2011 and 2010 are as follows (in thousands):

	2011	2010
Gain on trading securities	\$	\$ (1,706)
Loss on Auction-Rate Securities Rights		1,910
Other	348	(423)
Other expense (income), net	\$ 348	\$ (219)

During the three months ended March 31, 2010, the value of our trading auction-rate securities increased by \$1.7 million. The increases in fair value were more than offset by losses recorded as a result of decreases in the fair value of our auction-rate securities rights totaling \$1.9 million. On June 30, 2010, our auction-rate securities rights were exercised. Accordingly, the related asset was written off and our auction-rate securities then classified as trading securities were sold.

**Income Tax.** Income tax for the three months ended March 31, 2011 decreased to \$33.4 million from \$36.4 million in the comparable 2010 period. This decrease is due to the decrease in our effective income tax rate to 32.9% for the three months ended March 31, 2011 from 37.6% in the comparable 2010 period. The decrease in the effective income tax rate is primarily due to the first quarter 2011 benefit for non-taxable income from noncontrolling interests, the reinstatement of the Research and Development credit by Congress in December 2010, an increase in the Domestic Production Activity deduction during the period ended March 31, 2011, a decrease in the fair value of contingent consideration, which resulted in non-taxable income during the period ended March 31, 2011, partially offset by a first quarter 2011 non-deductible charge resulting from the Branded Prescription drug fee and a charge for transaction costs related to our recent and pending acquisitions.

**2011 Outlook.** We continue to estimate that our 2011 total revenues will be between \$2.35 billion and \$2.45 billion. Our estimate is based on the continued growth of both our generic and branded product portfolios, driven by ongoing prescription demand for our key inline products, including Lidoderm®, Opana® ER, and Voltaren® Gel, and by new revenues from launching Fortesta™ Gel as well as the full-year effect of our acquisitions of Qualitest and HealthTronics. Cost of revenues as a percent of total revenues is expected to increase when compared to 2010. This increase is expected due to a full year of amortization expense associated with the intangible assets acquired with Qualitest and HealthTronics as well as a full year's change in mix of revenues as a result of the Qualitest, Penwest, and HealthTronics acquisitions. Selling, general and administrative expenses, as a percentage of revenues, are expected to decline in 2011, relative to 2010, reflecting new approaches to customer segmentation and marketing, annualized effects of the prior year's cost reduction efforts and forecasted synergies associated with our 2010 acquisitions. Absolute Selling, general and administrative expenses, however, will increase, reflecting the full year effects of our acquisitions. As well, we will continue to provide promotional support behind our key on-market products. Research and development expenses are expected to increase due to the addition of Qualitest's research and development portfolio to our existing programs, the progress of our branded pharmaceutical portfolio's development, as well as the expansion of our efforts in the pharmaceutical discovery and device research and development areas. Of course, there can be no assurance that the Company will achieve these results.

**Business Segment Results Review**

As a result of our recent acquisitions, the Company realigned its internal management reporting in 2010 to reflect a total of three reportable segments. These segments reflect the level at which executive management regularly reviews financial information to assess performance and to make decisions about resources to be allocated.

The three reportable business segments in which the Company now operates include: (1) Branded Pharmaceuticals, (2) Generics and (3) Devices and Services. Each segment derives revenue from the sales or licensing of their respective products or services and is discussed below.

**Branded Pharmaceuticals.** This group of products includes a variety of branded prescription products related to treating and managing pain as well as our urology, endocrinology and oncology products. The established products that are included in this operating segment includes Lidoderm®, Opana® ER and Opana®, Percocet®, Voltaren® Gel, Frova®, Supprelin® LA, Vantas®, and Valstar®.

**Generics.** This segment is comprised of our legacy Endo non-branded generic portfolio and the portfolio from our newly acquired Qualitest business. Our generics business has historically focused on selective generics related to pain that have one or more barriers to market entry, such as complex formulation, regulatory or legal challenges or difficulty in raw material sourcing. With the addition of Qualitest, the segment's product offerings now include products in the pain management, urology, central nervous system (CNS) disorder, immunosuppression, oncology and hypertension markets, among others.

***Devices and Services.*** The Devices and Services operating segment provides urological services, products and support systems to urologists, hospitals, surgery centers and clinics across the United States. These services and products are sold through the five following business lines: lithotripsy services, prostate treatment services, radiation therapy services, anatomical pathology services, and medical products manufacturing, sales and maintenance. These business lines are discussed in greater detail within Note 5.

**Table of Contents**

In 2010, the Company began to evaluate segment performance based on each segment's adjusted income (loss) before income tax. We define adjusted income (loss) before income tax as income (loss) before income tax before certain upfront and milestone payments to partners, acquisition-related items, cost reduction initiatives, asset impairment charges, amortization of commercial intangible assets related to marketed products, inventory step-up recorded as part of our acquisitions, non-cash interest expense, and certain other items that the Company believes do not reflect its core operating performance.

Certain corporate general and administrative expenses are not allocated and are therefore included within Corporate unallocated. We calculate consolidated adjusted income (loss) before income tax by adding the adjusted income (loss) before income tax of each of our reportable segments to corporate unallocated adjusted income (loss) before income tax.

Endo refers to adjusted income (loss) before income tax in making operating decisions because it believes it provides meaningful supplemental information regarding the Company's operational performance. For instance, Endo believes that this measure facilitates its internal comparisons to its historical operating results and comparisons to competitors' results. The Company believes this measure is useful to investors in allowing for greater transparency related to supplemental information used by Endo in its financial and operational decision-making. In addition, Endo has historically reported similar financial measures to its investors and believes that the inclusion of comparative numbers provides consistency in its financial reporting at this time. Further, Endo believes that adjusted income (loss) before income tax may be useful to investors as it is aware that certain of its significant stockholders utilize adjusted income (loss) before income tax to evaluate its financial performance. Finally, adjusted income (loss) before income tax is utilized in the calculation of adjusted diluted net income per share, which is used by the Compensation Committee of Endo's Board of Directors in assessing the performance and compensation of substantially all of its employees, including its executive officers.

There are limitations to using financial measures such as adjusted income (loss) before income tax. Other companies in our industry may define adjusted income (loss) before income tax differently than we do. As a result, it may be difficult to use adjusted income (loss) before income tax or similarly named adjusted financial measures that other companies may use to compare the performance of those companies to our performance. Because of these limitations, adjusted income (loss) before income tax should not be considered as a measure of the income generated by our business or discretionary cash available to us to invest in the growth of our business. The Company compensates for these limitations by providing reconciliations of our consolidated adjusted income (loss) before income tax to our consolidated income before income tax, which is determined in accordance with U.S. GAAP and included in the accompanying Condensed Consolidated Statements of Operations.

**Revenues.** The following table displays our revenue by reportable segment for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	<b>Three months ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Branded Pharmaceuticals	\$ 375,514	\$ 338,536
Generics	134,409	25,876
Devices and Services	50,103	
Total revenues	\$ 560,026	\$ 364,412

**Branded Pharmaceuticals.** Net pharmaceutical product sales during the three months ended March 31, 2011 increased 11% to \$375.5 million from \$338.5 million in the comparable 2010 period. This increase was primarily driven by increased revenues of Lidoderm®, Opana® ER and Opana® and Voltaren® Gel.

**Generics.** Net pharmaceutical product sales during the three months ended March 31, 2011 increased 419% to \$134.4 million from \$25.9 million in the comparable 2010 period. This increase was primarily driven by our acquisition of Qualitest in November 2010, which contributed \$106.4 million of net sales to our Generics segment during the three months ended March 31, 2011.

**Devices and Services.** Revenue during the three months ended March 31, 2011 was \$50.1 million. This amount consists entirely of revenues during the three months ended March 31, 2011 from the acquisition of HealthTronics in July 2010.

**Table of Contents**

**Adjusted income (loss) before income tax.** The following table displays our adjusted income (loss) before income tax by reportable segment for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	<b>Three months ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Branded Pharmaceuticals	\$ 193,256	\$ 169,324
Generics	26,387	3,246
Devices and Services	14,441	
Corporate unallocated	(56,269)	(44,354)
<b>Total consolidated adjusted income before income tax</b>	<b>\$ 177,815</b>	<b>\$ 128,216</b>

**Branded Pharmaceuticals.** Adjusted income before income tax during the three months ended March 31, 2011 increased 14% to \$193.3 million from \$169.3 million in the comparable 2010 period. This increase was primarily driven by increased revenues from our Branded Pharmaceuticals segment as well as the decrease in the royalty expense to Penwest from \$7.2 million in the first quarter of 2010 to zero in the comparable 2011 period. This royalty was eliminated upon our acquisition of Penwest in the third quarter of 2010.

**Generics.** Adjusted income before income tax during the three months ended March 31, 2011 increased 713% to \$26.4 million from \$3.2 million in the comparable 2010 period. This increase was primarily driven by increased revenues from our Generics segment as well as decreased research and development expense as a percentage of sales.

**Devices and Services.** Adjusted income before income tax during the three months ended March 31, 2011 was \$14.4 million. This amount consists entirely of the operating results of HealthTronics, which we acquired in July 2010.

**Corporate unallocated.** Corporate unallocated adjusted loss before income tax during the three months ended March 31, 2011 increased 27% to \$56.3 million from \$44.4 million in the comparable 2010 period, which is primarily attributable to the overall growth of our business and the related increase in corporate costs, including an increase in interest expense of \$2.6 million, excluding the amortization of deferred financing fees which are not included in adjusted income before tax. Corporate unallocated adjusted loss before income tax as a percent of consolidated total revenues decreased to 10% in the first quarter of 2011 compared to 12% in the first quarter of 2010. These fluctuations were primarily driven by the favorable impact of companywide cost reduction initiatives.

**Reconciliation to GAAP.** The table below provides reconciliations of our consolidated adjusted income (loss) before income tax to our consolidated income before income tax, which is determined in accordance with U.S. GAAP, for the three months ended March 31, 2011 and 2010 (in thousands):

	<b>Three months ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Total consolidated adjusted income before income tax	\$ 177,815	\$ 128,216
Upfront and milestone payments to partners	(11,001)	(3,000)
Acquisition-related items	(6,073)	(1,529)
Cost reduction initiatives	(3,462)	(5,494)
Amortization of commercial intangible assets related to marketed products	(37,211)	(17,217)
Inventory step-up	(13,786)	
Non-cash interest expense	(4,541)	(4,050)
Other (expense) income		(204)
<b>Total consolidated income before income tax</b>	<b>\$ 101,741</b>	<b>\$ 96,722</b>

**LIQUIDITY AND CAPITAL RESOURCES**

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Our principal source of liquidity is cash generated from operations. Our principal liquidity requirements are for working capital for operations, licenses, milestone payments, capital expenditures and debt service payments. The Company continues to maintain a sufficient level of working capital, which was approximately \$710.0 million at March 31, 2011 compared to \$623.7 million at December 31, 2010. Historically, we have generated positive cash flow from operating activities and have had access to broad financial markets that provide liquidity. Cash, cash equivalents and current marketable securities were approximately \$565.2 million at March 31, 2011 compared to \$466.2 million at December 31, 2010. Cash and cash equivalents at March 31, 2011 and December 31, 2010 primarily consisted of bank deposits, time deposits and money market funds.

In 2011, we expect that sales of our currently marketed branded and generic products as well as our devices and services will allow us to continue to generate positive cash flow from operations. We expect cash generated from operations together with our cash, cash equivalents and current marketable securities to be sufficient to cover cash needs for working capital, general corporate expenses, the payment of contractual obligations, including scheduled principal and interest payments on our outstanding borrowings and any regulatory and/or sales milestones that may become due. We intend to obtain additional funding for our pending acquisition of American Medical Systems Holdings, Inc., which is expected to close in the third quarter of 2011.



**Table of Contents**

Beyond 2011, we expect cash generated from operations together with our cash, cash equivalents and marketable securities to continue to be sufficient to cover cash needs for working capital and general corporate purposes, certain acquisitions of other businesses, including the potential payments of up to approximately \$337.3 million in contingent cash consideration payments related to our acquisitions of Indevus and Qualitest, products, product rights, or technologies, the payment of contractual obligations, including principal and interest payments on our indebtedness and our Revolving Credit Facility (defined below), and certain minimum royalties due to Novartis and the regulatory or sales milestones that may become due. At this time, we cannot accurately predict the effect of certain developments on the rate of sales growth, such as the degree of market acceptance, patent protection and exclusivity of our products, the impact of competition, the effectiveness of our sales and marketing efforts and the outcome of our current efforts to develop, receive approval for and successfully launch our near-term product candidates. Any of the above could adversely affect our future cash flows. We may need to obtain additional funding for future transactions, to repay our outstanding indebtedness, or for our future operational needs, and we cannot be certain that funding will be available on terms acceptable to us, or at all.

We may also elect to incur additional debt or issue equity or convertible securities to finance ongoing operations, acquisitions or to meet our other liquidity needs. Any issuances of equity securities or convertible securities could have a dilutive effect on the ownership interest of our current shareholders and may adversely impact net income per share in future periods. An acquisition may be accretive or dilutive and by its nature, involve numerous risks and uncertainties.

**2010 Credit Facility and 2009 Credit Facility.** In October 2009, we established a \$300 million, three-year senior secured revolving credit facility (the 2009 Credit Facility) with JP Morgan Chase Bank, Barclays Capital and certain other lenders. The 2009 Credit Facility was available for letters of credit, working capital and general corporate purposes. The 2009 Credit Facility also permitted up to \$100 million of additional revolving or term loan commitments from one or more of the existing lenders or other lenders.

On November 30, 2010, we terminated our 2009 Credit Facility and established a \$400 million, five-year senior secured term loan facility (the Term Loan Facility), and a \$500 million, five-year senior secured revolving credit facility (the Revolving Credit Facility and, together with the Term Loan Facility, the 2010 Credit Facility) with JP Morgan Chase Bank, Royal Bank of Canada, and certain other lenders. The 2010 Credit Facility was established primarily to finance our acquisition of Qualitest and is available for working capital, general corporate purposes, up to \$30 million of letters of credit, and up to \$30 million of swing line loans (the Swing Line Loans) on same-day notice. The agreement governing the 2010 Credit Facility (the 2010 Credit Agreement) also permits up to \$200 million of additional revolving or term loan commitments from one or more of the existing lenders or other lenders with the consent of JP Morgan Chase Bank, as Administrative Agent, without the need for consent from any of the existing lenders under the 2010 Credit Facility.

The obligations of the Company under the 2010 Credit Facility are guaranteed by certain of the Company's domestic subsidiaries and are secured by substantially all of the assets of the Company and the subsidiary guarantors. The 2010 Credit Facility contains certain usual and customary covenants, including, but not limited to covenants to maintain a maximum leverage ratio and minimum interest coverage ratio as well as limitations on capital expenditures, asset sales, mergers and acquisitions, indebtedness, liens, dividends, investments and transactions with the Company's affiliates. Borrowings under the 2010 Credit Facility will bear interest at an amount equal to a rate calculated based on the type of borrowing and the Company's Leverage Ratio from time to time. For term loans and revolving loans (other than Swing Line Loans), the Company may elect to pay interest based on an adjusted LIBOR rate plus between 2.00% and 2.75% or an Alternate Base Rate (as defined in the 2010 Credit Agreement) plus between 1.00% and 1.75%. The Company will also pay a commitment fee of between 35 to 50 basis points, payable quarterly, on the average daily unused amount of the Revolving Credit Facility based on the Company's Leverage Ratio from time to time.

**7.00% Senior Notes Senior Notes due 2020.** On November 23, 2010, we entered into an indenture among the Company, the guarantors named therein and Wells Fargo Bank, National Association, as trustee, which governs the terms of the Company's \$400.0 million aggregate principal amount of 7.00% Senior Notes due 2020 (the Senior Notes). The Senior Notes were issued in a private offering exempt from the registration requirements of the Securities Act of 1933, as amended (the Securities Act) to qualified institutional buyers in accordance with Rule 144A and to persons outside of the United States pursuant to Regulation S under the Securities Act. The Senior Notes are senior unsecured obligations of the Company and are guaranteed on a senior unsecured basis by certain of the Company's domestic subsidiaries. The Company used the net proceeds of the Senior Notes offering to partially finance the acquisition of Qualitest, and to pay related fees and expenses.

The Senior Notes bear interest at a rate of 7.00% per year, accruing from November 23, 2010. Interest on the Senior Notes is payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2011. The Senior Notes will mature on December 15, 2020, subject to earlier repurchase or redemption in accordance with the terms of the indenture governing the Senior Notes. The indenture governing the Senior Notes contains covenants that, among other things, restrict the Company's ability and the ability of certain of its restricted subsidiaries to incur certain additional indebtedness and issue preferred stock; make certain



**Table of Contents**

dividends, distributions, investments and other restricted payments; sell certain assets; agree to any restrictions on the ability of restricted subsidiaries to make payments to the Company; create certain liens; enter into transactions with affiliates; designate subsidiaries as unrestricted subsidiaries; and consolidate, merge or sell substantially all of the Company's assets. These covenants are subject to a number of important exceptions and qualifications, including the fall away or revision of certain of these covenants upon The Senior Notes receiving investment grade credit ratings.

**16% Non-recourse Notes due 2024.** On August 26, 2008, Indevus closed a private placement to institutional investors of \$105.0 million in aggregate principal amount of 16% non-convertible, non-recourse, secured promissory notes due 2024 (Non-recourse Notes). The Non-recourse Notes were issued by Ledgemont Royalty Sub LLC (Royalty Sub), which was a wholly-owned subsidiary of Indevus at the time of the Non-recourse Note issuance and subsequently became a wholly-owned subsidiary of the Company upon our acquisition of Indevus. As of the Indevus Acquisition Date, the Company recorded these notes at their fair value of approximately \$115.2 million and began amortizing these notes to their face value of \$105.0 million at maturity in 2024.

In August 2009, the Company commenced a cash tender offer for any and all outstanding Non-recourse notes. The purpose of the tender offer was to acquire any and all Notes to reduce our consolidated interest expense. The tender offer included an early tender deadline, whereby holders of the Non-recourse Notes could early tender and receive the total early consideration of \$1,000 per \$1,000 principal amount of the Non-recourse notes. Holders who tendered their Non-recourse Notes after such time and at or prior to the expiration of the tender offer period were eligible to receive the tender offer consideration of \$950 per \$1,000 principal amount of Non-recourse notes, which was the total early consideration less the early tender payment. The tender offer expired on September 24, 2009, at 5:00 p.m., New York City time (the Expiration Time). As of the Expiration Time, \$48 million in Non-recourse Notes had been validly tendered and not withdrawn. The Company accepted for payment and purchased Non-recourse Notes at a purchase price of \$1,000 per \$1,000 principal amount, for a total amount of approximately \$48 million (excluding accrued and unpaid interest up to, but not including, the payment date for the Non-recourse Notes, fees and other expenses in connection with the tender offer). The aggregate principal amount of Non-recourse Notes purchased represents approximately 46% of the \$105 million aggregate principal amount of Non-recourse Notes that were outstanding prior to the Expiration Time. Accordingly, the Company recorded a \$4.0 million gain on the extinguishment of debt, net of transaction costs. The gain was calculated as the difference between the aggregate amount paid to purchase the Non-recourse Notes and their carrying amount.

During the third quarter of 2010, Endo notified the holders of its intent to exercise its option to redeem the remaining \$57 million of principal at 108% of the principal amount for approximately \$62 million (amount excludes accrued and unpaid interest) on November 5, 2010. The Non-recourse Notes were redeemed in November 2010.

**1.75% Convertible Senior Subordinated Notes due 2015.** As discussed in Note 15 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Report, in April 2008, we issued \$379.5 million in aggregate principal amount of 1.75% Convertible Senior Subordinated Notes due April 15, 2015 (the Convertible Notes) in a private offering for resale to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended.

We received proceeds of approximately \$370.7 million from the issuance, net of the initial purchaser's discount and certain other costs of the offering. Interest is payable semi-annually in arrears on each April 15 and October 15 with the first interest payment being made on October 15, 2008. The Convertible Notes will mature on April 15, 2015, unless earlier converted or repurchased by us.

Holders of the Convertible Notes may convert their notes based on a conversion rate of 34.2466 shares of our common stock per \$1,000 principal amount of notes (the equivalent of \$29.20 per share), subject to adjustment upon certain events, only under the following circumstances as described in the Indenture for the Convertible Notes (the Indenture): (1) during specified periods, if the price of our common stock reaches specified thresholds; (2) if the trading price of the Convertible Notes is below a specified threshold; (3) at any time after October 15, 2014; or (4) upon the occurrence of certain corporate transactions. We will be permitted to deliver cash, shares of Endo common stock or a combination of cash and shares, at our election, to satisfy any future conversions of the notes. It is our current intention to settle the principal amount of any conversion consideration in cash.

**Share Repurchase Program.** Pursuant to our previously announced \$750 million share repurchase plan, we may, from time to time, seek to repurchase our equity in open market purchases, privately-negotiated transactions, accelerated stock repurchase transactions or otherwise. This program does not obligate Endo to acquire any particular amount of common stock. Repurchase activity, if any, will depend on factors such as levels of cash generation from operations, cash requirements for investment in the Company's business, timing and extent of future business development activity, repayment of future debt, if any, current stock price, market conditions and other factors. The share repurchase program may be suspended, modified or discontinued at any time. As a result of a two-year extension approved by the Board of Directors in February 2010, the share repurchase plan is set to expire in April 2012. Pursuant to the existing share repurchase program, we purchased approximately 0.5 million shares of our common stock during the period ended March 31, 2011 totaling \$17.6 million and approximately 1.2 million shares of our common stock during the period ended March 31, 2010 totaling \$29.0 million.

**Marketable Securities.** Beginning in 2008 and continuing through 2011, the securities and credit markets have been experiencing severe volatility and disturbance, increasing risk with respect to certain of our financial assets. As a result of our auction-rate securities rights agreement with UBS (described in more detail below), we have been able to minimize our credit risk losses. On

## **Table of Contents**

June 30, 2010, we were able to exercise our auction-rate securities rights (the Rights), described below, with UBS and liquidate our remaining UBS auction-rate security portfolio at par value. At March 31, 2011, \$18.8 million of our marketable securities portfolio was invested in auction-rate debt securities with ratings of AAA. Our investment policy seeks to preserve the value of capital, consistent with maximizing return on the Company's investment, while maintaining adequate liquidity and security. This policy specifically prohibits the investment in auction-rate securities as well as the investment in any security that is below investment grade. However, such restrictions were implemented on a prospective basis and did not impact the Company's ability to continue to hold the auction-rate securities it was invested in when the amended investment policy was adopted.

The underlying assets of our auction-rate securities are student loans. Student loans are insured by the Federal Family Education Loan Program, or FFELP.

The Company determined that an income approach (present value technique) that maximizes the use of observable market inputs is the preferred approach to measuring the fair value of our securities. Specifically, the Company used the discount rate adjustment technique to determine an indication of fair value.

To calculate a price for our auction-rate securities, the Company calculates duration to maturity, coupon rates, market required rates of return (discount rate) and a discount for lack of liquidity in the following manner:

The Company identifies the duration to maturity of the auction-rate securities as the time at which principal is available to the investor. This can occur because the auction-rate security is paying a coupon that is above the required rate of return, and the Company treats the security as being called. It can also occur because the market has returned to normal and the Company treats the auctions as having recommenced. Lastly, and most frequently, the Company treats the principal as being returned as prepayment occurs and at the maturity of the security. The initial life used for each remaining security, representing time to maturity, was eight years as of March 31, 2011 and December 31, 2010.

The Company calculates coupon rates based on estimated relationships between the maximum coupon rate (the coupon rate in event of a failure) and market interest rates. The representative coupon rate was 5.23% on March 31, 2011 and 5.10% at December 31, 2010. The Company calculates appropriate discount rates for securities that include base interest rates, index spreads over the base rate, and security-specific spreads. These spreads include the possibility of changes in credit risk over time. The spread over the base rate applied to our securities was 202 basis points at March 31, 2011 and 218 basis points at December 31, 2010.

The Company believes that a market participant would require an adjustment to the required rate of return to adjust for the lack of liquidity. We do not believe it is unreasonable to assume a 150 basis points adjustment to the required rate of return and a term of either three, four or five years to adjust for this lack of liquidity. The increase in the required rate of return decreases the prices of the securities. However, the assumption of a three, four or five-year term shortens the times to maturity and increases the prices of the securities. The Company has evaluated the impact of applying each term and the reasonableness of the range indicated by the results. The Company chose to use a four-year term to adjust for the lack of liquidity as we believe it is the point within the range that is most representative of fair value. The Company's conclusion is based in part on the fact that the fair values indicated by the results are reasonable in relation to each other given the nature of the securities and current market conditions.

We did not sell any of our remaining auction-rate securities during the three months ended March 31, 2011. During the three-month period ended March 31, 2010, we sold \$32.5 million of auction-rate securities at par value. Given the uncertainty in the auction-rate securities market, the Company cannot predict when future auctions related to our existing auction-rate securities portfolio will be successful. However, we do not employ an asset management strategy or tax planning strategy that would require us to sell any of our existing securities at a loss. Furthermore, there have been no adverse changes in our business or industry that could require us to sell the securities at a loss in order to meet working capital requirements.

In October 2008, UBS AG (UBS) made an offer (the UBS Offer) to the Company and other clients of UBS Securities LLC and UBS Financial Services Inc. (collectively, the UBS Entities), pursuant to which the Company received auction-rate securities rights to sell to UBS all auction-rate securities held by the Company as of February 13, 2008 in a UBS account (the Eligible Auction-Rate Securities). The Rights permitted us to require UBS to purchase the Eligible Auction-Rate Securities for a price equal to par value plus any accrued but unpaid dividends or interest beginning on June 30, 2010 and ending on July 2, 2012.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

On November 10, 2008, the Company accepted the UBS Offer, awarding the UBS Entities the sole discretion and right to sell or otherwise dispose of, and/or enter orders in the auction process with respect to the Eligible Auction-Rate Securities on the Company's behalf until the expiration date, without prior notification, so long as the Company receives a payment of par value plus any accrued but unpaid dividends or interest upon any sale or disposition. As of June 30, 2010, we exercised the Rights and, on July 1, 2010, received cash for our remaining UBS portfolio at par. Accordingly, as of June 30, 2010, our UBS auction-rate securities were reclassified into a current receivable. The remaining \$18.8 million of our auction-rate securities portfolio, at par-value, is not held in a UBS account and therefore was not subject to the UBS Offer.

**Table of Contents**

As of March 31, 2011, the yields on our long-term auction-rate securities ranged from 0.54% to 0.60%. These yields represent the predetermined maximum reset rates that occur upon auction failures according to the specific terms within each security's prospectus. As of March 31, 2011, the weighted average yields for our long-term auction-rate securities were 0.57%. Total interest recognized on our auction-rate securities during the three months ended March 31, 2011 and March 31, 2010 was less than \$0.1 million and \$0.3 million, respectively. The issuers have been making interest payments promptly.

At March 31, 2011, the fair value of our auction-rate securities, as determined by applying the above described discount rate adjustment technique, was approximately \$17.4 million, representing a 7%, or \$1.4 million discount from their original purchase price or par value. This compares to approximately \$17.3 million, representing an 8%, or \$1.5 million discount from their original purchase price or par value at December 31, 2010. Had the Company chosen to apply a three or five year term with respect to the liquidity adjustment at March 31, 2011, the resultant discount to the original purchase price or par value would have been \$1.1 million and \$1.7 million, respectively. We believe we have appropriately reflected our best estimate of the assumptions that market participants would use in pricing the assets in a current transaction to sell the asset at the measurement date.

At March 31, 2011 and December 31, 2010, the fair value of our auction-rate securities rights was zero. The decrease in fair value from December 31, 2009 to March 31, 2010 of \$1.9 million was recognized as a charge to earnings and included in Other expense (income), net in the Condensed Consolidated Statements of Operations.

**Working Capital.** Working capital increased to \$710.0 million as of March 31, 2011 from \$623.7 million as of December 31, 2010. The components of our working capital as of March 31, 2011 and December 31, 2010 are below:

	<b>March 31, 2011</b>	<b>December 31, 2010</b>
Total current assets	\$ 1,498,174	\$ 1,359,534
Less: Total current liabilities	(788,092)	(735,828)
<b>Working capital</b>	<b>\$ 710,082</b>	<b>\$ 623,706</b>

Working capital increased primarily due to our cash flows from operations which were offset slightly by \$17.6 million in share repurchases, \$12.6 million in distributions to noncontrolling interests, and \$11.7 million in capital expenditures during the three months ended March 31, 2011.

The following table summarizes our Condensed Consolidated Statements of Cash Flows and liquidity for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	<b>Three month ended March 31, 2011</b>	<b>Three month ended March 31, 2010</b>
Net cash flow provided by (used in):		
Operating activities	\$ 131,058	\$ 109,405
Investing activities	(13,271)	29,310
Financing activities	(18,839)	(27,205)
Net increase in cash and cash equivalents	98,948	111,510
Cash and cash equivalents, beginning of period	466,214	708,462
Cash and cash equivalents, end of period	\$ 565,162	\$ 819,972
Current ratio	1.9:1	2.9:1
Days sales outstanding	46	45

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

**Net Cash Provided by Operating Activities.** Net cash provided by operating activities was \$131.1 million for the three months ended March 31, 2011 compared to \$109.4 million for the three months ended March 31, 2010. Significant components of our operating cash flows for the three months ended March 31, 2011 and 2010 are as follows (in thousands):

	<b>Three month ended March 31, 2011</b>	<b>Three month ended March 31, 2010</b>
<b>Cash Flow Data-Operating Activities:</b>		
Consolidated net income	\$ 68,295	\$ 60,355
Depreciation and amortization	47,741	21,521
Stock-based compensation	7,416	3,791
Change in fair value of acquisition-related contingent consideration	(685)	890



**Table of Contents**

	Three month ended March 31, 2011	Three month ended March 31, 2010
Loss on auction-rate securities rights		1,910
Unrealized gain on trading securities		(1,706)
Changes in assets and liabilities which provided cash:	2,893	11,440
Other, net	5,398	11,204
<b>Net cash provided by operating activities</b>	<b>\$ 131,058</b>	<b>\$ 109,405</b>

The increase in net cash provided by operating activities compared to the prior year was primarily attributable to increased consolidated net income in a period of increasing depreciation, amortization, stock-based compensation, and other costs which do not impact net cash provided by operating activities. This increase was partially offset by a decrease in cash inflows during the first quarter of 2011 from changes in assets and liabilities which provided cash, as compared to the first quarter of 2010.

**Net Cash Used in/Provided by Investing Activities.** Net cash used in investing activities was \$13.3 million for the three months ended March 31, 2011 compared to net cash provided by investing activities of \$29.3 million during the same period of 2010. The change is primarily related to the absence of \$32.5 million of proceeds from the sale of available-for-sale securities, as well as an additional \$9.4 million in capital expenditures in the first quarter of 2011 compared to the comparable 2010 period.

**Net Cash Used in Financing Activities.** Net cash used in financing activities was \$18.8 million for the three months ended March 31, 2011 compared to net cash used in financing activities of \$27.2 million during the three months ended March 31, 2010. The decrease to net cash used in financing activities was primarily a result of a \$10.9 million increase in cash proceeds from the exercise of stock options and an \$11.5 million decrease in stock repurchases during the first quarter of 2011 as compared to the first quarter of 2010. The effects of these differences were partially offset by a \$12.6 million increase in distributions to noncontrolling interests and a \$4.2 million increase in net principal payments on debt during the first quarter of 2011 compared to the first quarter of 2010.

**Research and Development.** Over the past few years, we have incurred significant expenditures related to conducting clinical studies to develop new pharmaceutical products and exploring the value of our existing products in treating disorders beyond those currently approved in their respective labels. We may seek to mitigate the risk in, and expense of, our research and development programs by entering into collaborative arrangements with third parties. However, we intend to retain a portion of the commercial rights to these programs and, as a result, we still expect to spend significant funds on our share of the cost of these programs, including the costs of research, preclinical development, clinical research and manufacturing.

We expect to continue to incur significant levels of research and development expenditures as we focus on the development and advancement of our product pipeline. There can be no assurance that results of any ongoing or future pre-clinical or clinical trials related to these projects will be successful, that additional trials will not be required, that any drug or product under development will receive FDA approval in a timely manner or at all, or that such drug or product could be successfully manufactured in accordance with U.S. current Good Manufacturing Practices, or successfully marketed in a timely manner, or at all, or that we will have sufficient funds to develop or commercialize any of our products.

**Manufacturing, Supply and Other Service Agreements.** We contract with various third-party manufacturers and suppliers to provide us with raw materials used in our products, finished goods, and certain services. Our most significant agreements are with Novartis Consumer Health, Inc., Novartis AG, Teikoku Seiyaku Co., Ltd., Mallinckrodt Inc., Noramco, Inc., Sharp Corporation, and Ventiv Commercial Services, LLC. If, for any reason, we are unable to obtain sufficient quantities of any of the finished goods or raw materials or components required for our products, it could have a material adverse effect on our business, financial condition, results of operations and cash flows. For a complete description of commitments under manufacturing, supply and other service agreements, see Note 12 of the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

On March 11, 2011, the northeast coast of Japan experienced a severe earthquake followed by a tsunami, with continuing aftershocks. These geological events have caused significant damage in the region, including severe damage to nuclear power plants, and have impacted Japan's power and other infrastructure as well as its economy. Teikoku Seiyaku Co., Ltd., our sole supplier of Lidoderm®, is located in Southeast Japan. The Company does not currently believe these events will have a material impact on its business, results of operations, financial condition or cash flows in the first quarter of 2011.

***License and Collaboration Agreements.*** We have agreed to certain contingent payments in certain of our license, collaboration and other agreements. Payments under these agreements generally become due and payable only upon the achievement of certain developmental, regulatory, commercial and/or other milestones. Due to the fact that it is uncertain if and when these milestones will be achieved, such contingencies have not been recorded in our Condensed Consolidated Balance Sheets. In addition, under certain arrangements, we may have to make royalty payments based on a percentage of future sales of the products in the event regulatory approval for marketing is obtained. From a business perspective, we view these payments favorably as they signify that the products are moving successfully through the development phase toward commercialization. For a complete description of our contingent payments involving our license and collaboration agreements, see Note 8, and Note 12 of the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

---

## **Table of Contents**

**Acquisitions.** As part of our business strategy, we plan to consider and, as appropriate, make acquisitions of other businesses, products, product rights or technologies. Our cash reserves and other liquid assets may be inadequate to consummate such acquisitions and it may be necessary for us to issue stock or raise substantial additional funds in the future to complete future transactions. In addition, as a result of our acquisition efforts, we are likely to experience significant charges to earnings for merger and related expenses (whether or not our efforts are successful) that may include transaction costs, closure costs or costs of restructuring activities.

### ***American Medical Systems Holdings, Inc.***

On April 10, 2011, Endo, NIKA Merger Sub, Inc., an indirect wholly owned subsidiary of Endo and AMS entered into the AMS Merger Agreement. Pursuant to the AMS Merger Agreement, Endo will acquire all of the outstanding stock of AMS for a purchase price of \$30.00 per share in cash, without interest, and Merger Sub will merge with and into AMS with AMS continuing as the surviving corporation and an indirect wholly owned subsidiary of Endo. The completion of the AMS Merger is subject to customary conditions, including the approval of AMS stockholders, the absence of any material adverse effect on AMS business and receiving certain antitrust approvals (including under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended). The merger is expected to close in the third quarter.

Pursuant to the AMS Merger Agreement, each issued and outstanding share of AMS common stock will be converted into the right to receive the AMS Merger Consideration. Each option to acquire AMS common stock which is vested and exercisable immediately prior to the AMS Merger will be canceled and terminated in exchange for the right to receive the AMS Merger Consideration minus the exercise price per share of the option. All other options will be converted into options to acquire Endo common stock on comparable economic terms and conditions as were applicable to such options immediately prior to the AMS Merger. Each issued and outstanding share of restricted AMS common stock that is subject to vesting restrictions that would vest within one year of the closing of the AMS Merger will be converted into the right to receive the AMS Merger Consideration. All other restricted AMS common stock subject to vesting restrictions will be converted into restricted shares of Endo common stock with comparable economic terms and conditions as were applicable to such restricted AMS shares immediately prior to the AMS Merger.

The AMS Merger Agreement contains customary representations, warranties, termination provisions, and covenants by AMS and Endo. In connection with the Merger, Endo has entered into financing commitments with Morgan Stanley and Bank of America Merrill Lynch. Morgan Stanley and Bank of America Merrill Lynch have also backstopped the Company's current \$500 million revolving credit facility. The Company currently expects to close the transaction with cash on hand, up to \$2.4 billion in term loans, and about \$700 million in bonds. Between now and closing, however, the Company will continue to explore opportunities to further optimize its capital structure. Funding is contingent on the closing of the Merger and certain other conditions; financing is not a condition to the obligations of Endo or Merger Sub under the terms of the Merger Agreement.

In connection with the Merger, Endo has entered into a commitment pursuant to which Morgan Stanley Senior Funding, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Bank of America, N.A. have, among other things, agreed to (i) structure, arrange and syndicate a bridge loan facility to Endo in an aggregate principal amount of \$700 million, (ii) arrange a senior secured term loan A facility in an aggregate principal amount of \$1.5 billion, (iii) arrange a senior secured term loan B facility in an aggregate principal amount of \$900 million and (iv) arrange a multicurrency revolving credit facility in an initial aggregate principal amount of \$500 million. The funding of the Debt Financing is contingent on the closing of the Merger and certain other conditions set forth in the Commitment Letter. The funding of the Debt Financing is not a condition to the obligations of Endo or Merger Sub under the terms of the Merger Agreement.

### ***Qualitest***

On November 30, 2010 (the Qualitest Acquisition Date), Endo completed its acquisition of all of the issued and outstanding capital stock of Generics International (US Parent), Inc. (Qualitest) from an affiliate of Apax Partners, L.P. for approximately \$769.4 million. In addition, Endo paid \$406.8 million to retire Qualitest's outstanding debt and related interest rate swap on November 30, 2010. In connection with the Qualitest acquisition, \$108 million of the purchase price was placed into escrow. One of the escrow amounts is for \$8 million and will be used to fund any working capital adjustments, as defined in the Qualitest Stock Purchase Agreement. We expect this escrow to be settled in 2011. There is also a \$100 million escrow account that will be used to fund all claims arising out of or related to the Qualitest acquisition.

In connection with the \$100 million escrow account, to the extent that we are able to realize tax benefits for costs that are funded by the escrow account, we will be required to share these tax benefits with Apax.

Qualitest is a manufacturer and distributor of generic drugs and over-the-counter pharmaceuticals throughout the United States. Qualitest's product portfolio is comprised of 175 product families in various forms including tablets, capsules, creams, ointments, suppositories, and liquids. This acquisition will enable us to gain critical mass in our generics business while strengthening our pain portfolio through a larger breadth of

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

product offerings.

The operating results of Qualitest from November 30, 2010 are included in the accompanying Condensed Consolidated Statements of Operations. The Consolidated Balance Sheet as of March 31, 2011 and December 31, 2010 reflect the acquisition of Qualitest, effective November 30, 2010, the date the Company obtained control of Qualitest.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the Qualitest Acquisition Date (in thousands):

	November 30, 2010 (As initially reported)	Measurement period adjustments	November 30, 2010 (As adjusted)
Cash and cash equivalents	\$ 21,828	\$	\$ 21,828
Accounts receivable	93,228		93,228
Other receivables	1,483		1,483
Inventories	95,000		95,000
Prepaid expenses and other current assets	2,023		2,023
Deferred income taxes	63,509	4,817	68,326
Property, Plant and equipment	135,807		135,807
Other intangible assets	843,000	(7,000)	836,000
<b>Total identifiable assets</b>	<b>\$ 1,255,878</b>	<b>\$ (2,183)</b>	<b>\$ 1,253,695</b>
Accounts payable	\$ 27,422	\$	\$ 27,422
Accrued expenses	55,210	1,012	56,222
Deferred income taxes	207,733	(2,758)	204,975
Long-term debt	406,758		406,758
Other liabilities	9,370		9,370
<b>Total liabilities assumed</b>	<b>\$ 706,493</b>	<b>\$ (1,746)</b>	<b>\$ 704,747</b>
Net identifiable assets acquired	\$ 549,385	\$ (437)	\$ 548,948
Goodwill	\$ 219,986	\$ 437	\$ 220,423
<b>Net assets acquired</b>	<b>\$ 769,371</b>	<b>\$</b>	<b>\$ 769,371</b>

The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the Qualitest Acquisition Date. The Company believes that information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the Qualitest Acquisition Date.

**Table of Contents**

The valuation of the intangible assets acquired and related amortization periods are as follows:

	Valuation (in millions)	Amortization Period (in years)
<b>Developed Technology:</b>		
Hydrocodone and acetaminophen	\$ 119.0	17
Oxycodone and acetaminophen	30.0	17
Promethazine	46.0	16
Isosorbide Mononitrate ER	42.0	16
Multi Vitamins	38.0	16
Trazodone	17.0	16
Butalbital, acetaminophen, and caffeine	25.0	16
Triprevifem	16.0	13
Spironolactone	13.0	17
Hydrocortisone	34.0	16
Hydrochlorothiazide	16.0	16
Controlled Substances	52.0	16
Oral Contraceptives	8.0	13
Others	162.0	17
Total	\$ 618.0	16
<b>In Process Research &amp; Development:</b>		
Generics portfolio with anticipated 2011 launch	\$ 63.0	n/a
Generics portfolio with anticipated 2012 launch	30.0	n/a
Generics portfolio with anticipated 2013 launch	17.0	n/a
Generics portfolio with anticipated 2014 launch	88.0	n/a
Total	\$ 198.0	n/a
<b>Tradename:</b>		
Qualitest tradename	\$ 20.0	15
Total	\$ 20.0	15
Total other intangible assets	\$ 836.0	n/a

The fair value of the developed technology assets and in-process research and development assets were estimated using an income approach. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the intangible asset over its remaining useful life. To calculate fair value, the Company used probability-weighted cash flows discounted at rates considered appropriate given the inherent risks associated with each type of asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. Cash flows were generally assumed to extend through the shorter of the patent or estimated useful life of the developed technology or in-process research and development asset. The fair value of the Qualitest Tradename was estimated using an income approach, specifically known as the relief from royalty method. The relief from royalty method is based on a hypothetical royalty stream that would be received if the Company were to license the Qualitest Tradename. Thus, we derived the hypothetical royalty income from the projected revenues of Qualitest.

The \$220.4 million of goodwill was assigned to our Generics segment, which was established in November 2010 pursuant to our acquisition of Qualitest. The goodwill recognized is attributable primarily to expected purchasing, manufacturing and distribution synergies as well as their assembled workforce. Approximately \$170.4 million of goodwill is expected to be deductible for income tax purposes.

Deferred tax assets of \$68.3 million are related primarily to federal and state net operating loss and credit carryforwards of Qualitest and its subsidiaries. Deferred tax liabilities of \$205.0 million are related primarily to the difference between the book basis and tax basis of identifiable

intangible assets.

**Table of Contents**

The Company recognized \$3.2 million of Qualitest acquisition-related costs that were expensed for the three months ended March 31, 2011. These costs are included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations and are comprised of the following items (in thousands):

	<b>Acquisition-related Costs Three months ended March 31, 2011</b>
Investment bank fees, includes Endo and Qualitest	\$
Legal, separation, integration, and other costs	3,241
<b>Total</b>	<b>\$ 3,241</b>

The following supplemental pro forma information presents the financial results as if the acquisition of Qualitest had occurred on January 1, 2010 for the three months ended March 31, 2010. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made on January 1, 2010, nor are they indicative of any future results.

	<b>Three months ended March 31, 2010</b>
<b>Pro forma consolidated results (in thousands, except per share data):</b>	
Revenue	\$ 444,811
Net income attributable to Endo Pharmaceuticals Holdings Inc.	\$ 59,784
Basic net income per share	\$ 0.51
Diluted net income per share	\$ 0.51

These amounts have been calculated after applying the Company's accounting policies and adjusting the results of Qualitest to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments primarily to property, plant and equipment, and intangible assets, had been applied on January 1, 2010, together with the consequential tax effects.

**Penwest Pharmaceuticals Co.**

On September 20, 2010 (the Penwest Acquisition Date), the Company completed its tender offer for the outstanding shares of common stock of Penwest, at which time Penwest became a majority-owned subsidiary of the Company. On November 4, 2010, we closed this acquisition immediately following a special meeting of shareholders of Penwest at which they approved the merger. We paid approximately \$171.8 million in aggregate cash consideration. Penwest is now our wholly-owned subsidiary.

This transaction contributes to Endo's core pain management franchise and permits us to maximize the value of our oxymorphone franchise.

The operating results of Penwest from September 20, 2010 are included in the accompanying Condensed Consolidated Statements of Operations. The Condensed Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010 reflect the acquisition of Penwest, effective September 20, 2010, the date the Company obtained control of Penwest.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the Penwest Acquisition Date (in thousands):

	<b>September 20, 2010 (As initially reported)</b>	<b>Measurement period adjustments</b>	<b>September 20, 2010 (As adjusted)</b>
Cash and cash equivalents	\$ 22,343	\$	\$ 22,343
Marketable securities	800		800
Accounts receivable	10,885	(19)	10,866

Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Other receivables	132	(1)	131
Inventories	396	11	407
Prepaid expenses and other current assets	716	(223)	493
Deferred income taxes	27,175	3,003	30,178
Property and equipment	1,115	(200)	915
Other intangible assets	111,200		111,200
Other assets	2,104		2,104
<b>Total identifiable assets</b>	<b>\$ 176,866</b>	<b>\$ 2,571</b>	<b>\$ 179,437</b>
Accounts payable	\$ 229	\$	\$ 229
Income taxes payable	347	(187)	160
Penwest shareholder liability	20,815	(20,815)	
Accrued expenses	1,455	87	1,542
Deferred income taxes	39,951	379	40,330



**Table of Contents**

	September 20, 2010 (As initially reported)	Measurement period adjustments	September 20, 2010 (As adjusted)
Other liabilities	4,403	118	4,521
Total liabilities assumed	\$ 67,200	\$ (20,418)	\$ 46,782
Net identifiable assets acquired	\$ 109,666	\$ 22,989	\$ 132,655
Goodwill	\$ 37,952	\$ 1,159	\$ 39,111
Net assets acquired	\$ 147,618	\$ 24,148	\$ 171,766

The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the Penwest Acquisition Date to estimate the fair value of assets acquired and liabilities assumed. The Company believes that information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts, particularly with respect to intangible assets and deferred taxes. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the Penwest Acquisition Date.

The valuation of the intangible assets acquired and related amortization periods are as follows (in millions):

	Valuation	Amortization Period (in years)
<b>In Process Research &amp; Development:</b>		
Otsuka	\$ 5.5	n/a
A0001	1.6	n/a
Total	\$ 7.1	n/a
<b>Developed Technology:</b>		
Opana® ER	\$ 104.1	10
Total	\$ 104.1	10
Total other intangible assets	\$ 111.2	n/a

The fair values of the in-process research and development assets and developed technology asset were estimated using an income approach. To calculate fair value, the Company used probability-weighted cash flows discounted at rates considered appropriate given the inherent risks associated with the asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. Cash flows were generally assumed to extend through the shorter of the patent or estimated useful life of our developed technology or in-process research and development asset.

The \$39.1 million of goodwill was assigned to our Branded Pharmaceuticals segment. The goodwill recognized is attributable primarily to the control premium associated with our oxymorphone franchise and other factors. None of the goodwill is expected to be deductible for income tax purposes.

Deferred tax assets of \$30.2 million are related primarily to federal net operating loss and credit carryforwards of Penwest. Deferred tax liabilities of \$40.3 million are related primarily to the difference between the book basis and tax basis of the identifiable intangible assets.

The Company recognized less than \$0.1 million of Penwest acquisition-related costs that were expensed for the three months ended March 31, 2011. These costs are included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations.

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

Due to the pro forma impacts of eliminating the pre-existing intercompany royalties between Penwest and Endo, which were determined to be at fair value, we have not provided supplemental pro forma information as amounts are not material to the Condensed Consolidated Statements of Operations. We have also considered the impacts of Penwest, since the date we obtained a majority interest, on our Consolidated Statement of Operations and concluded amounts were not material.

### ***HealthTronics, Inc.***

On July 2, 2010 (the HealthTronics Acquisition Date), the Company completed its initial tender offer for all outstanding shares of common stock of HealthTronics and obtained effective control of HealthTronics. On July 12, 2010, Endo completed its acquisition of HealthTronics for approximately \$214.8 million in aggregate cash consideration for 100% of the outstanding shares, at which time

**Table of Contents**

HealthTronics became a wholly-owned subsidiary of the Company. HealthTronics shares were purchased at a price of \$4.85 per HealthTronics Share. In addition, Endo paid \$40 million to retire HealthTronics debt that had been outstanding under its Senior Credit Facility. As a result of the acquisition, the HealthTronics Senior Credit Facility was terminated.

HealthTronics is a provider of healthcare services and manufacturer of medical devices, primarily for the urology community. The HealthTronics business and applicable services include:

*Lithotripsy services.* HealthTronics provides lithotripsy services, which is a medical procedure where a device called a lithotripter transmits high energy shockwaves through the body to break up kidney stones. Lithotripsy services are provided principally through limited partnerships and other entities that HealthTronics manages, which use lithotripters. In 2010, physician partners used our lithotripters to perform approximately 50,000 procedures in the U.S. While the physicians render medical services, HealthTronics does not. As the general partner of limited partnerships or the manager of other types of entities, HealthTronics also provide services relating to operating its lithotripters, including scheduling, staffing, training, quality assurance, regulatory compliance, and contracting with payors, hospitals, and surgery centers.

*Prostate treatment services.* HealthTronics provides treatments for benign and cancerous conditions of the prostate. In treating benign prostate disease, HealthTronics deploys three technologies in a number of its partnerships above: (1) photo-selective vaporization of the prostate (PVP), (2) trans-urethral needle ablation (TUNA), and (3) trans-urethral microwave therapy (TUMT). All three technologies apply an energy source which reduces the size of the prostate gland. For treating prostate and other cancers, HealthTronics uses a procedure called cryosurgery, a process which uses lethal ice to destroy tissue such as tumors for therapeutic purposes. In April 2008, HealthTronics acquired Advanced Medical Partners, Inc., which significantly expanded its cryosurgery partnership base. In July 2009, HealthTronics acquired Endocare, Inc., which manufactures both the medical devices and related consumables utilized by its cryosurgery operations and also provides cryosurgery treatments. The prostate treatment services are provided principally by using equipment that HealthTronics leases from limited partnerships and other entities that HealthTronics manages. Benign prostate disease and cryosurgery cancer treatment services are billed in the same manner as its lithotripsy services under either retail or wholesale contracts. HealthTronics also provides services relating to operating the equipment, including scheduling, staffing, training, quality assurance, regulatory compliance, and contracting.

*Radiation therapy services.* HealthTronics provides image guided radiation therapy (IGRT) technical services for cancer treatment centers. Its IGRT technical services may relate to providing the technical (non-physician) personnel to operate a physician practice group's IGRT equipment, leasing IGRT equipment to a physician practice group, providing services related to helping a physician practice group establish an IGRT treatment center, or managing an IGRT treatment center.

*Anatomical pathology services.* HealthTronics provides anatomical pathology services primarily to the urology community. HealthTronics has one pathology lab located in Georgia, which provides laboratory detection and diagnosis services to urologists throughout the United States. In addition, in July 2008, HealthTronics acquired UroPath LLC, now referred to as HealthTronics Laboratory Solutions, which managed pathology laboratories located at UroPath sites for physician practice groups located in Texas, Florida and Pennsylvania. Through HealthTronics Laboratory Solutions, HealthTronics continues to provide administrative services to in-office pathology labs for practice groups and pathology services to physicians and practice groups with its lab equipment and personnel at the HealthTronics Laboratory Solutions laboratory sites.

*Medical products manufacturing, sales and maintenance.* HealthTronics manufactures and sells medical devices focused on minimally invasive technologies for tissue and tumor ablation through cryoablation, which is the use of lethal ice to destroy tissue, such as tumors, for therapeutic purposes. HealthTronics develops and manufactures these devices for the treatment of prostate and renal cancers and our proprietary technologies also have applications across a number of additional markets, including the ablation of tumors in the lung, liver metastases and palliative intervention (treatment of pain associated with metastases). HealthTronics manufactures the related spare parts and consumables for these devices. HealthTronics also sells and maintains lithotripters and related spare parts and consumables.

The acquisition of HealthTronics reflects Endo's desire to continue expanding our business beyond pain management into complementary medical areas where HealthTronics can be innovative and competitive. We believe this expansion will enable us to be a provider of multiple healthcare solutions and services that fill critical gaps in patient care.

The operating results of HealthTronics from July 2, 2010 are included in the accompanying Condensed Consolidated Statements of Operations. The Condensed Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010 reflect the acquisition of HealthTronics, effective July 2, 2010, the date the Company obtained control of HealthTronics.

**Table of Contents**

The following table summarizes the fair values of the assets acquired and liabilities assumed at the HealthTronics Acquisition Date (in thousands):

	July 2, 2010 (As initially reported)	Measurement period adjustments	July 2, 2010 (As Adjusted)
Cash and cash equivalents	\$ 6,769	\$	\$ 6,769
Accounts receivable	33,111	277	33,388
Other receivables	1,006		1,006
Inventories	12,399		12,399
Prepaid expenses and other current assets	5,204		5,204
Deferred income taxes	43,737	3,676	47,413
Property and equipment	30,687		30,687
Other intangible assets	65,866	7,258	73,124
Other assets	5,210		5,210
<b>Total identifiable assets</b>	<b>\$ 203,989</b>	<b>\$ 11,211</b>	<b>\$ 215,200</b>
Accounts payable	\$ 3,084	\$	\$ 3,084
Accrued expenses	11,551	8,959	20,510
Deferred income taxes	20,377	3,188	23,565
Long-term debt	44,751	(1,291)	43,460
Other liabilities	1,434	351	1,785
<b>Total liabilities assumed</b>	<b>\$ 81,197</b>	<b>\$ 11,207</b>	<b>\$ 92,404</b>
<b>Net identifiable assets acquired</b>	<b>\$ 122,792</b>	<b>\$ 4</b>	<b>\$ 122,796</b>
Noncontrolling interests	\$ (60,119)	\$ (3,108)	\$ (63,227)
Goodwill	\$ 152,170	\$ 3,104	\$ 155,274
<b>Net assets acquired</b>	<b>\$ 214,843</b>	<b>\$</b>	<b>\$ 214,843</b>

The above estimated fair values of assets acquired and liabilities assumed are provisional and are based on the information that was available as of the HealthTronics Acquisition Date to estimate the fair value of assets acquired and liabilities assumed. The Company believes that information provides a reasonable basis for estimating the fair values but the Company is waiting for additional information necessary to finalize those amounts, particularly with respect to the estimated fair value of noncontrolling interests and deferred income taxes. Thus, the provisional measurements of fair value reflected are subject to change. Such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the HealthTronics Acquisition Date.

The valuation of the intangible assets acquired and related amortization periods are as follows:

	Valuation (in millions)	Amortization Period (in years)
Endocare Developed Technology	\$ 46.3	10
HealthTronics Tradename	14.6	15
Service Contract	12.2	n/a
<b>Total</b>	<b>\$ 73.1</b>	<b>n/a</b>

The fair value of the developed technology asset was estimated using a discounted present value income approach. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

intangible asset over its remaining useful life. To calculate fair value, the Company used probability-weighted cash flows discounted at rates considered appropriate given the inherent risks associated with each type of asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. Cash flows were assumed to extend through the patent life of the purchased technology. The fair value of the HealthTronics Tradename was estimated using an income approach, specifically known as the relief from royalty method. The relief from royalty method is based on a hypothetical royalty stream that would be received if the Company were to license the HealthTronics Tradename. Thus, we derived the hypothetical royalty income from the projected revenues of HealthTronics services.

HealthTronics has investments in partnerships and limited liability companies (LLCs) where we, as the general partner or managing member, exercise effective control. Accordingly, we consolidate various entities where we do not own 100% of the entity in accordance with the accounting consolidation principles. As a result, we are required to fair value the noncontrolling interests as part of our purchase price allocation. To calculate fair value, the Company used historical transactions which represented Level 2 data points within the fair value hierarchy to calculate applicable multiples of each respective noncontrolling interest in the partnerships and LLCs.

**Table of Contents**

The \$155.3 million of goodwill was assigned to our Devices and Services segment, which was established in July 2010 pursuant to our acquisition of HealthTronics. The goodwill recognized is attributable primarily to strategic and synergistic opportunities across the HealthTronics network of urology partnerships, expected corporate synergies, the assembled workforce of HealthTronics and other factors. Approximately \$33.6 million of goodwill is expected to be deductible for income tax purposes.

Deferred tax assets of \$47.4 million are related primarily to federal net operating loss and credit carryforwards of HealthTronics and its subsidiaries. Deferred tax liabilities of \$23.6 million are related primarily to the difference between the book basis and tax basis of identifiable intangible assets.

The Company recognized \$1.4 million of HealthTronics acquisition-related costs that were expensed for the three months ended March 31, 2011. These costs are included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations and are comprised of the following items (in thousands):

	<b>Acquisition-related Costs Three months ended March 31, 2011</b>
Investment bank fees, includes Endo and HealthTronics	\$
Legal, separation, integration, and other costs	1,350
<b>Total</b>	<b>\$ 1,350</b>

The following supplemental pro forma information presents the financial results as if the acquisition of HealthTronics had occurred on January 1, 2010 for the three months ended March 31, 2010. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made on January 1, 2010, nor are they indicative of any future results.

	<b>Three months ended March 31, 2010</b>
<b>Pro forma consolidated results (in thousands, except per share data):</b>	
Revenue	\$ 412,801
Net income attributable to Endo Pharmaceuticals Holdings Inc.	\$ 61,708
Basic net income per share	\$ 0.53
Diluted net income per share	\$ 0.52

These amounts have been calculated after applying the Company's accounting policies and adjusting the results of HealthTronics to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments primarily to property, plant and equipment, and intangible assets, had been applied on January 1, 2010, together with the consequential tax effects.

---

**Table of Contents**

***Acquisition-Related Contingent Consideration***

As of March 31, 2011 and December 31, 2010, the fair value of the contingent consideration is \$16.2 million and \$7.1 million, respectively. The material components of this obligation are discussed below.

*Indevus*

On February 23, 2009 (the Indevus Acquisition Date), the Company completed its initial tender offer for all outstanding shares of common stock of Indevus. Through purchases in subsequent offer periods, the exercise of a top-up option and a subsequent merger, the Company completed its acquisition of Indevus on March 23, 2009, at which time Indevus became a wholly-owned subsidiary of the Company. The Indevus Shares were purchased at a price of \$4.50 per Indevus Share, net to the seller in cash, plus contractual rights to receive up to an additional \$3.00 per Indevus Share in contingent cash consideration payments related to potential future regulatory and commercial milestones related to Aveed<sup>TM</sup> (the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement) and the octreotide NDA for the treatment of acromegaly (the Octreotide Contingent Cash Consideration Agreement). Additionally, upon the acquisition of Indevus, the Company assumed a pre-existing contingent consideration obligation relating to Indevus' acquisition of Valera Pharmaceuticals, Inc. (the Valera Contingent Consideration Agreement), which could entitle former Valera shareholders to receive consideration from the Company upon FDA approval of the octreotide implant for the treatment for acromegaly.

The key terms and fair values of these three contingent consideration agreements (collectively, the Indevus Contingent Consideration Agreements) are as follows:

*Aveed<sup>TM</sup> Contingent Consideration* In the event that the Company receives an approval letter from the FDA with respect to the Aveed<sup>TM</sup> NDA on or before the third anniversary of the time at which we purchased the Indevus shares in the Offer, then the Company will (1) pay an additional \$2.00 per Indevus share to the former stockholders of Indevus if such approval letter grants the right to market and sell Aveed<sup>TM</sup> immediately and provides labeling for Aveed<sup>TM</sup> that does not contain a boxed warning (Aveed<sup>TM</sup> With Label) or alternatively, (2) pay an additional \$1.00 per Indevus share, if such approval letter grants the right to market and sell Aveed<sup>TM</sup> immediately and provides labeling for Aveed<sup>TM</sup> that contains a boxed warning (Aveed<sup>TM</sup> Without Label). In the event that either an Aveed<sup>TM</sup> With Label approval or an Aveed<sup>TM</sup> Without Label approval has not been obtained prior to the third anniversary of the closing of the Offer, then the Company will not pay, and the former Indevus stockholders will not receive, any payments under the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement.

Further, in the event that the Aveed<sup>TM</sup> Without Label approval is received and subsequently, Endo and its subsidiaries publicly report audited financial statements which reflect cumulative net sales of Aveed<sup>TM</sup> of at least \$125.0 million for four consecutive calendar quarters on or prior to the fifth anniversary of the date of the first commercial sale of Aveed<sup>TM</sup> (Aveed<sup>TM</sup> Net Sales Event), then the Company will, subject to the terms described below, pay an additional \$1.00 per Indevus share to the former stockholders of Indevus. In the event that the Aveed<sup>TM</sup> Net Sales Event does not occur prior to the fifth anniversary of the date of the first commercial sale of Aveed<sup>TM</sup> then the Company will not pay, and former Indevus stockholders will not receive, any additional amounts under the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement.

The range of the undiscounted amounts the Company could pay under the Aveed<sup>TM</sup> Contingent Cash Consideration Agreement is between zero and approximately \$175.0 million. Under this agreement, there are three scenarios that could potentially lead to amounts being paid to the former stockholders of Indevus. These scenarios are (1) obtaining an Aveed<sup>TM</sup> With Label approval, (2) obtaining an Aveed<sup>TM</sup> Without Label approval and (3) achieving the \$125.0 million sales milestone on or prior to the fifth anniversary of the date of the first commercial sale of Aveed<sup>TM</sup> should the Aveed<sup>TM</sup>

---

**Table of Contents**

Without Label approval be obtained. The fourth scenario is Aveed™ not receiving approval within three years of the closing of the Offer, which would result in no payment to the former stockholders of Indevus. Each scenario was assigned a probability based on the current regulatory status of Aveed™. The resultant probability-weighted cash flows were then discounted using a discount rate of U.S. Prime plus 300 basis points, which the Company believes is appropriate and is representative of a market participant assumption. Using this valuation technique, the fair value of the contractual obligation to pay the Aveed™ Contingent Consideration was determined to be \$133.1 million on the Indevus Acquisition Date, \$7.2 million at March 31, 2011, and \$7.1 million at December 31, 2010.

*Octreotide Contingent Consideration* In the event that an approval letter from the FDA is received with respect to an octreotide NDA (such approval letter, the Octreotide Approval) on or before the fourth anniversary of the closing of the Offer, then the Company will pay an additional \$1.00 per Indevus share to the former stockholders of Indevus (such payment, the Octreotide Contingent Cash Consideration Payment). In the event that an Octreotide Approval has not been obtained prior to the fourth anniversary of the closing of the Offer, then the Company will not pay, and the former Indevus stockholders shall not receive, the Octreotide Contingent Cash Consideration Payment.

The range of the undiscounted amounts the Company could pay under the Octreotide Contingent Cash Consideration Agreement is between zero and approximately \$91.0 million. Under this agreement, the two scenarios that require consideration are (1) Octreotide Approval on or before the fourth anniversary of the closing of the Offer or (2) no Octreotide Approval on or before the fourth anniversary of the closing of the Offer. Each scenario was assigned a probability based on the current development stage of octreotide. The resultant probability-weighted cash flows were then discounted using a discount rate of U.S. Prime plus 300 basis points, which the Company believes is appropriate and is representative of a market participant assumption. Using this valuation technique, the fair value of the contractual obligation to pay the Octreotide Contingent Consideration was determined to be \$39.8 million on the Indevus Acquisition Date and zero at both March 31, 2011 and December 31, 2010.

*Valera Contingent Consideration* In connection with our acquisition of Indevus, the Company assumed Indevus' pre-existing contingent obligations under the Valera Contingent Consideration Agreement, which was consummated on April 18, 2007. Prior to our acquisition of Indevus, the Valera Contingent Consideration Agreement entitled former Valera shareholders to receive additional Indevus shares based on an agreed upon conversion factor if FDA approval of the octreotide implant for the treatment for acromegaly was achieved on or before April 18, 2012 (Valera Triggering Event). Concurrently with Endo's acquisition of Indevus, each Valera shareholder's right to receive additional Indevus shares was converted into the right to receive, upon the occurrence of the Valera Triggering Event, the following amounts for each Indevus share that such former Valera shareholder would have received upon the occurrence of the Valera Triggering Event, if not for Endo's acquisition of Indevus: (1) \$4.50 plus (2) contractual rights to receive up to an additional \$3.00 in contingent cash consideration payments under the Aveed™ Contingent Cash Consideration Agreement and the Octreotide Contingent Cash Consideration Agreement.

The range of the undiscounted amounts the Company could pay under the Valera Contingent Cash Consideration Agreement is between zero and approximately \$33.0 million. The fair value of the Valera Contingent Consideration is estimated using the same assumptions used for the Aveed™ Contingent Cash Consideration Agreement and Octreotide Contingent Cash Consideration Agreement, except that the probabilities associated with the Valera Contingent Consideration take into account the probability of obtaining the Octreotide Approval on or before the fourth anniversary of the closing of the Offer. This is due to the fact that the Valera Contingent Consideration will not be paid unless octreotide for the treatment of acromegaly is approved prior to April 18, 2012. Using this valuation technique, the fair value of the contractual obligation to pay the Valera Contingent Consideration was determined to be \$13.7 million on the Indevus Acquisition Date and zero at both March 31, 2011 and December 31, 2010.

These amounts reflect management's current assessment of the probability of that it will not be obligated to make contingent consideration payments based on the anticipated timeline for the NDA filing and FDA approval of octreotide for the treatment of acromegaly. Future changes in any of our assumptions could result in further volatility to the estimated fair value of the acquisition-related contingent consideration. Such additional changes to fair value could materially impact our results of operations in future periods.

At March 31, 2010, the aggregate fair value of the three Indevus Contingent Consideration Agreements increased from \$7.1 million at December 31, 2010 to \$7.2 million at March 31, 2011. This increase primarily reflects changes of our present value assumptions associated with our valuation model. The increase in the liability was recorded as a loss and is included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations.

As of March 31, 2011, there were no changes to the range of the undiscounted amounts the Company may be required to pay under any of the Indevus Contingent Consideration Agreements.



*Qualitest*

On November 30, 2010 (the Qualitest Acquisition Date), Endo acquired Qualitest, who was party to an asset purchase agreement with Teva Pharmaceutical Industries Ltd (Teva) (the Teva Agreement). Pursuant to this agreement, Qualitest purchased certain pipeline generic products from Teva and could be obligated to pay consideration to Teva upon the achievement of certain future regulatory milestones (the Teva Contingent Consideration).

---

## **Table of Contents**

The range of the undiscounted amounts the Company could pay under the Teva Agreement is between zero and \$12.5 million. The Company is accounting for the Teva Contingent Consideration in the same manner as if it had entered into that arrangement with respect to its acquisition of Qualitest. Accordingly, the fair value was estimated based on a probability-weighted discounted cash flow model, or income approach. The resultant probability-weighted cash flows were then discounted using a discount rate of U.S. Prime plus 300 basis points. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement within the fair value hierarchy. Using this valuation technique, the fair value of the contractual obligation to pay the Teva Contingent Consideration was determined to be \$9.0 million on the Qualitest Acquisition Date and December 31, 2010 and was determined to be \$8.2 million at March 31, 2011.

The decrease from December 31, 2010 to March 31, 2011 primarily reflects changes of our present value assumptions associated with our valuation model. The decrease in the liability was recorded as a gain and is included in Acquisition-related items in the accompanying Condensed Consolidated Statements of Operations.

As of March 31, 2011, there were no changes to the range of the undiscounted amounts the Company may be required to pay under the Teva Agreement.

**Legal Proceedings.** We are subject to various patent, product liability, government investigations and other legal proceedings in the ordinary course of business. Contingent accruals are recorded when we determine that a loss related to a litigation matter is both probable and reasonably estimable. Due to the fact that legal proceedings and other contingencies are inherently unpredictable, our assessments involve significant judgments regarding future events. For a complete description of legal proceedings, see Note 12 of the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

**Fluctuations.** Our quarterly results have fluctuated in the past, and may continue to fluctuate. These fluctuations may be due to the timing of new product launches, purchasing patterns of our customers, market acceptance of our products, the impact of competitive products and pricing, impairment of intangible assets, separation benefits, business combination transaction costs, upfront, milestone and certain other payments made or accrued pursuant to licensing agreements and changes in the fair value of financial instruments and contingent assets and liabilities recorded as part of a business combination. Further, a substantial portion of our net pharmaceutical product sales are through three wholesale drug distributors who in turn supply our products to pharmacies, hospitals and physicians. Accordingly, we are potentially subject to a concentration of credit risk with respect to our trade receivables.

**Growth Opportunities.** We continue to evaluate growth opportunities including strategic investments, licensing arrangements, acquisitions of businesses, product rights or technologies, and strategic alliances and promotional arrangements which could require significant capital resources. We intend to continue to focus our business development activities on further diversifying our revenue base through product licensing and company acquisitions, as well as other opportunities to enhance stockholder value. Through execution of our business strategy we intend to focus on developing new products through both an internal and a virtual research and development organization with greater scientific and clinical capabilities; expanding the Company's product line by acquiring new products and technologies in existing therapeutic and complementary areas; increasing revenues and earnings through sales and marketing programs for our innovative product offerings and effectively using the Company's resources; and providing additional resources to support our generics business.

**Non-U.S. Operations.** We currently have no material operations outside of the United States. As a result, fluctuations in foreign currency exchange rates do not have a material effect on our financial statements.

**Inflation.** We do not believe that inflation had a material adverse effect on our financial statements for the periods presented.

**Off-Balance Sheet Arrangements.** We have no off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

## **CRITICAL ACCOUNTING ESTIMATES**

For a complete discussion of the Company's critical accounting estimates, see "Critical Accounting Estimates" in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission on February 28, 2011.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2010, the Financial Accounting Standards Board (FASB) issued additional Accounting Standards Update (ASU) 2010-29 on interim and annual disclosure of pro forma financial information related to business combinations. The new guidance clarifies the acquisition date that should be used for reporting the pro forma financial information in which comparative financial statements are presented. It is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning

## Edgar Filing: ENDO PHARMACEUTICALS HOLDINGS INC - Form 10-Q

on or after December 15, 2010.

In December 2010, the FASB issued additional ASU 2010-28 on accounting for goodwill. The guidance clarifies the impairment test for reporting units with zero or negative carrying amounts. The guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2011. The adoption is not expected to have a material impact on the company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-27 on accounting for the annual fee imposed by the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act. The new guidance specifies that the liability for the fee should be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense. It is effective on a prospective basis for calendar years beginning after December 31, 2010. We expect this fee will be approximately \$11 million in 2011, which will be charged as an operating expense ratably throughout 2011.

**Table of Contents**

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

For quantitative and qualitative disclosures about market risk, see Item 7A, Quantitative and Qualitative Disclosures about Market Risk. of our annual report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission on February 28, 2011. Our exposures to market risk have not changed materially since December 31, 2010.

**Item 4. Controls and Procedures.**

***Evaluation of Disclosure Controls and Procedures***

The Company's management, with the participation of the Company's Chief Executive Officer and Principal Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as of March 31, 2011. Based on that evaluation, the Company's Chief Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2011.

***Changes in Internal Control over Financial Reporting***

The Company acquired HealthTronics, Inc., Penwest Pharmaceuticals Co., and Generics International (US Parent), Inc. (Qualitest) on July 2, 2010, September 20, 2010, and November 30, 2010, respectively. The Company began to integrate these acquired companies into its internal control over financial reporting structure subsequent to their respective acquisition dates. As such, there have been changes during the three months ended March 31, 2011 associated with the continued establishment and implementation of internal control over financial reporting with respect to these acquired companies.

There were no other changes in the Company's internal control over financial reporting during the first quarter of 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

The disclosures under Note 12. Commitments and Contingencies-Legal Proceedings included in Part 1 Item I of this Report is incorporated in this Part II, Item 1 by reference.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 2. Unregistered Sale of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Removed and Reserved.**

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

The information called for by this item is incorporated by reference to the Exhibit Index of this Report.

Table of Contents

**SIGNATURES**

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

ENDO PHARMACEUTICALS HOLDINGS INC.

(Registrant)

*/s/ DAVID P. HOLVECK*  
Name: **David P. Holveck**  
Title: **President and Chief Executive Officer**

**(Principal Executive Officer)**

*/s/ ALAN G. LEVIN*  
Name: **Alan G. Levin**  
Title: **Executive Vice President, Chief Financial Officer**

**(Principal Financial Officer)**

*/s/ DANIEL A. RUDIO*  
Name: **Daniel A. Rudio**  
Title: **Vice President, Controller and Principal Accounting Officer (Principal Accounting Officer)**

Date: April 29, 2011

**Table of Contents**

**Exhibit Index**

<b>Exhibit</b>	
<b>No.</b>	<b>Title</b>
10.104	Agreement and Plan of Merger, among Endo Pharmaceuticals Holdings Inc., NIKA Merger Sub, Inc. and American Medical Systems Holdings, Inc., dated as of April 10, 2011 (incorporated herein by reference to Exhibit 2.1 of the Current Report on Form 8-K date April 15, 2011)
10.105	Commitment Letter to Endo Pharmaceutical Holdings, Inc., from Morgan Stanley Senior Funding, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Bank of America, N.A., dated April 10, 2011 (incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K dated April 15, 2011)
10.106	Form of Amended and Restated Performance Award Agreement under the 2007 Stock Incentive Plan
10.107	Form of Performance Award Agreement under the 2010 Stock Incentive Plan
21	Subsidiaries of the Registrant
31.1	Certification of the President and Chief Executive Officer of Endo pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer of Endo pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the President and Chief Executive Officer of Endo pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer of Endo pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial statements from the Endo Pharmaceuticals Holdings Inc. Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed on April 29, 2011, formatted in Extensive Business Reporting Language (XBRL), tagged as blocks of text: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) the Notes to the Condensed Consolidated Financial Statements.