

KING PHARMACEUTICALS INC

Form 10-Q

August 07, 2007

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

Form 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended **June 30, 2007**
- OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File No. 001-15875

King Pharmaceuticals, Inc.

(Exact name of registrant as specified in its charter)

Tennessee

(State or other jurisdiction of incorporation or organization)

54-1684963

(I.R.S. Employer Identification No.)

501 Fifth Street, Bristol, TN

(Address of principal executive offices)

37620

(Zip Code)

(423) 989-8000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

Number of shares outstanding of registrant's common stock as of August 6, 2007: 244,270,495

TABLE OF CONTENTS

	Page
Part I Financial Information	
Item 1. Financial Statements	3
Condensed Consolidated Balance Sheets	3
Condensed Consolidated Statements of Operations	4
Condensed Consolidated Statements of Changes in Shareholders' Equity and Other Comprehensive Income	5
Condensed Consolidated Statements of Cash Flows	6
Notes to Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	35
Item 3. Quantitative and Qualitative Disclosures about Market Risk	61
Item 4. Controls and Procedures	61
Part II Other Information	
Item 1. Legal Proceedings	61
Item 1A. Risk Factors	61
Item 4. Submission of Matters to a Vote of Security Holders	62
Item 6. Exhibits	63
Signatures	64

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

	June 30, 2007	December 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 54,705	\$ 113,777
Investments in debt securities	867,998	890,185
Accounts receivable, net of allowance for doubtful accounts of \$5,457 and \$5,437, respectively	261,057	263,939
Inventories	185,382	202,577
Deferred income tax assets	63,021	81,991
Income taxes receivable	2,188	
Prepaid expenses and other current assets	62,469	106,595
Current assets held for sale	15,602	14,409
Total current assets	1,512,422	1,673,473
Property, plant and equipment, net	241,937	244,382
Intangible assets, net	1,002,703	790,313
Goodwill	129,046	121,152
Marketable securities	11,237	11,578
Deferred income tax assets	305,902	271,554
Other assets (includes restricted cash of \$16,199 and \$15,968, respectively)	102,269	93,347
Assets held for sale	72,829	123,732
Total assets	\$ 3,378,345	\$ 3,329,531
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	\$ 70,188	\$ 77,158
Accrued expenses	350,925	510,137
Income taxes payable		30,501
Total current liabilities	421,113	617,796
Long-term debt	400,000	400,000
Other liabilities	68,221	23,129

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

Total liabilities	889,334	1,040,925
Commitments and contingencies (Note 8)		
Shareholders' equity	2,489,011	2,288,606
Total liabilities and shareholders' equity	\$ 3,378,345	\$ 3,329,531

See accompanying notes.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Revenues:				
Net sales	\$ 522,330	\$ 478,560	\$ 1,018,036	\$ 943,159
Royalty revenue	20,396	21,085	40,720	40,721
Total revenues	542,726	499,645	1,058,756	983,880
Operating costs and expenses:				
Cost of revenues, exclusive of depreciation amortization and impairments shown below	125,530	107,048	236,984	199,452
Selling, general and administrative, exclusive of co-promotion fees				
Co-promotion fees	125,684	107,126	248,038	212,180
Co-promotion fees	47,524	47,032	93,482	112,321
Total selling, general and administrative expense	173,208	154,158	341,520	324,501
Research and development				
Research and development	37,355	34,630	69,626	64,512
Research and development-in process upon acquisition	3,100		3,100	85,000
Total research and development	40,455	34,630	72,726	149,512
Depreciation and amortization				
Asset impairments	40,412	38,547	76,090	72,912
Restructuring charges (Note 12)	74,810	279	74,810	279
		(8)	460	(8)
Total operating costs and expenses	454,415	334,654	802,590	746,648
Operating income	88,311	164,991	256,166	237,232
Other income (expense):				
Interest income	8,517	8,393	17,783	14,353
Interest expense	(1,853)	(3,047)	(3,878)	(6,031)
(Loss) gain on early extinguishment of debt		(313)		709
Other, net	278	(204)	(265)	(714)
Total other income	6,942	4,829	13,640	8,317

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

Income from continuing operations before income taxes	95,253	169,820	269,806	245,549
Income tax expense	30,394	59,017	88,893	83,911
Income from continuing operations	64,859	110,803	180,913	161,638
Discontinued operations (Note 16):				
(Loss) income from discontinued operations	(115)	157	(335)	(90)
Income tax (benefit) expense	(41)	57	(120)	(32)
Total (loss) income from discontinued operations, net	(74)	100	(215)	(58)
Net income	\$ 64,785	\$ 110,903	\$ 180,698	\$ 161,580
Income per common share:				
Basic:				
Income from continuing operations	\$ 0.27	\$ 0.46	\$ 0.74	\$ 0.67
Total (loss) income from discontinued operations				
Net income	\$ 0.27	\$ 0.46	\$ 0.74	\$ 0.67
Diluted:				
Income from continuing operations	\$ 0.26	\$ 0.46	\$ 0.74	\$ 0.67
Total (loss) income from discontinued operations				
Net income	\$ 0.26	\$ 0.46	\$ 0.74	\$ 0.67

See accompanying notes.

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

	Common Stock		Unearned	Retained	Accumulated Other Comprehensive Income	Total
	Shares	Amount	Compensation	Earnings	(Loss)	
Balance at December 31, 2005	242,493,416	\$ 1,222,246	\$ (8,764)	\$ 754,953	\$ 4,987	\$ 1,973,422
Adoption of Statement of Financial Accounting Standard 123(R)		(8,764)	8,764			
Comprehensive income:						
Net income				161,580		161,580
Net unrealized loss on marketable securities, net of tax of \$2,857					(5,305)	(5,305)
Foreign currency translation					83	83
Total comprehensive income						156,358
Stock-based compensation expense		9,714				9,714
Exercise of stock options	409,023	7,073				7,073
Issuance of share-based awards	188,745					
Balance at June 30, 2006	243,091,184	\$ 1,230,269	\$	\$ 916,533	\$ (235)	\$ 2,146,567
Balance at December 31, 2006	243,151,223	\$ 1,244,986	\$	\$ 1,043,902	\$ (282)	\$ 2,288,606
Comprehensive income:						
Net income				180,698		180,698
Net unrealized loss on marketable securities, net of tax						
Foreign currency translation					567	567
Total comprehensive income						181,265

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

Adoption of Financial Accounting Standards Board Interpretation No. 48				(1,523)		(1,523)
Stock-based compensation expense		10,959				10,959
Exercise of stock options	590,282	9,704				9,704
Issuance of share-based awards	422,501					
Balance at June 30, 2007	244,164,006	\$ 1,265,649	\$	\$ 1,223,077	\$ 285	\$ 2,489,011

See accompanying notes.

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

	Six Months Ended	
	June 30,	
	2007	2006
Cash flows provided by operating activities	\$ 252,722	\$ 170,444
Cash flows from investing activities:		
Transfers (to) from restricted cash	(231)	128,874
Purchases of investments in debt securities	(869,683)	(766,117)
Proceeds from maturities and sales of investments in debt securities	891,870	482,152
Purchases of property, plant and equipment	(18,094)	(20,403)
Proceeds from sale of property and equipment	3	
Acquisition of Avinza®	(296,492)	
Loan repayment from Ligand	37,750	
Purchases of product rights and intellectual property	(15,058)	(24,085)
Arrow International Limited collaboration agreement	(50,000)	(35,000)
Net cash used in investing activities	(319,935)	(234,579)
Cash flows from financing activities:		
Proceeds from exercise of stock options, net	9,156	6,698
Excess tax benefits from stock-based compensation	608	397
Proceeds from issuance of long-term debt		400,000
Payments on long-term debt		(338,434)
Debt issuance costs	(1,623)	(10,659)
Net cash provided by financing activities	8,141	58,002
Decrease in cash and cash equivalents	(59,072)	(6,133)
Cash and cash equivalents, beginning of period	113,777	30,014
Cash and cash equivalents, end of period	\$ 54,705	\$ 23,881

See accompanying notes.

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2007 and 2006****(Unaudited)****(In thousands, except share and per share data)****1. General**

The accompanying unaudited interim condensed consolidated financial statements of King Pharmaceuticals, Inc. (King or the Company) were prepared by the Company in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, accordingly, 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, all adjustments (consisting of items of a normal recurring nature) considered necessary for a fair presentation are included. Operating results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The year-end condensed balance sheet was derived from the audited consolidated financial statements but does not include all disclosures required by generally accepted accounting principles.

These unaudited interim condensed consolidated financial statements include the accounts of King and all of its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Certain amounts from the prior condensed consolidated financial statements have been reclassified to conform to the current presentation. For additional information, please see Note 6.

2. Earnings Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Basic income per common share:				
Weighted average common shares	242,745,937	242,208,955	242,568,089	242,115,699
Diluted income per common share:				
Weighted average common shares	242,745,937	242,208,955	242,568,089	242,115,699
Effect of stock options	813,989	298,864	648,956	330,135
Effect of dilutive share awards	990,441	246,878	893,426	222,173
Weighted average common shares	244,550,367	242,754,697	244,110,471	242,668,007

For the three months ended June 30, 2007, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted income per share, included options to purchase 1,646,974 shares of common stock, 81,849 restricted stock awards (RSAs) and 1,088,145 long-term performance units (LPU's). For the six months ended June 30, 2007, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of

diluted income per share included options to purchase 1,813,405 shares of common stock, 51,876 RSAs, and 580,508 LPUs. The 11/4% Convertible Senior Notes due April 1, 2026 could be converted into the Company's common stock in the future, subject to certain contingencies. Shares of the Company's common stock associated with this right of conversion were excluded from the calculation of diluted income per share because these notes are anti-dilutive since the conversion price of the notes was greater than the average market price of the Company's common stock during the quarter.

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

For the three months ended June 30, 2006, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted income per share included options to purchase 5,718,592 shares of common stock, 145,849 RSAs and 933,565 LPUs. For the six months ended June 30, 2006, the weighted average shares that were anti-dilutive, and therefore excluded from the calculation of diluted income per share included options to purchase 5,346,456 shares of common stock, 80,927 RSAs and 501,205 LPUs. As of June 30, 2006, the 23/4% Convertible Debentures due November 15, 2021 could also convert into 84,868 shares of common stock in the future, subject to certain contingencies outlined in the indenture. Since the convertible debentures were anti-dilutive, they were not included in the calculation of diluted income per common share. The 11/4% Convertible Senior Notes due April 1, 2026 could be converted into common stock in the future, subject to certain contingencies. Shares of the Company's common stock associated with this right of conversion were excluded from the calculation of diluted income per share because these notes were anti-dilutive since the conversion price of the notes was greater than the average market price of the Company's common stock during the quarter.

3. Inventories

Inventories consist of the following:

	June 30, 2007	December 31, 2006
Raw materials	\$ 111,501	\$ 135,164
Work-in-process	17,025	17,885
Finished goods (including \$7,390, and \$6,813 of sample inventory, respectively)	65,625	62,395
	194,151	215,444
Inventory valuation allowance	(8,769)	(12,867)
Total inventories	\$ 185,382	\$ 202,577

4. Acquisitions, Dispositions, Co-Promotions and Alliances

On July 14, 2007, the Company entered into an asset purchase agreement with JHP Pharmaceuticals, LLC, (JHP), pursuant to which JHP will acquire the Company's Rochester, Michigan sterile manufacturing facility, some of the Company's legacy products that are manufactured there, and the related contract manufacturing business. The Company will retain its Bicillin® (sterile penicillin products) manufacturing facility which is also located in Rochester, Michigan. For additional information, please see Note 6.

On May 18, 2007, the Company entered into a Product Development Agreement with Mutual Pharmaceutical Company (Mutual) and United Research Laboratories (United) to jointly research and develop one or more improved formulations of metaxalone. Under this agreement, the Company seeks Mutual's expertise in developing improved formulations of metaxalone, including certain improved formulations Mutual developed prior to execution of this agreement and access to Mutual's and United's rights in intellectual property pertaining to such formulations. The success of this project depends on additional development activities and FDA approval. The Company paid \$3,100 to

Mutual for previously incurred development expenses, which was recorded as in process research and development in the branded pharmaceutical segment. The estimated cost to complete the project at the execution of the agreement was approximately \$5,000. In addition, the Company could be required to make additional milestone payments of up to \$10,000.

On September 6, 2006, the Company entered into a definitive asset purchase agreement and related agreements with Ligand Pharmaceuticals Incorporated (Ligand) to acquire rights to Ligand s product Avinza[®] (morphine sulfate extended release). Avinza[®] is an extended release formulation of morphine and is

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

indicated as a once-daily treatment for moderate to severe pain in patients who require continuous opioid therapy for an extended period of time. The Company completed its acquisition of Avinza® on February 26, 2007, acquiring all the rights to Avinza® in the United States, its territories and Canada. Under the terms of the asset purchase agreement the purchase price was \$289,657, consisting of \$289,332 in cash consideration and \$325 for the assumption of a short-term liability. Additionally, the Company incurred acquisition costs of \$6,737. Of the cash payments made to Ligand, \$15,000 is set aside in an escrow account to fund potential liabilities Ligand could later owe the Company.

As part of the transaction, the Company has agreed to pay Ligand an ongoing royalty and assume payment of Ligand's royalty obligations to third parties. The royalty the Company will pay to Ligand consists of a 15% royalty during the first 20 months after the closing date. Subsequent royalty payments to Ligand will be based upon calendar year net sales of Avinza® as follows:

If calendar year net sales are less than \$200,000 the royalty payment will be 5% of all net sales.

If calendar year net sales are greater than \$200,000 then the royalty payment will be 10% of all net sales up to \$250,000, plus 15% of net sales greater than \$250,000.

In connection with the transaction, on October 12, 2006, the Company entered into a loan agreement with Ligand for the amount of \$37,750. The principal amount of the loan was to be used solely for the purpose of paying a specific liability related to Avinza®. The loan was subject to certain market terms, including a 9.5% interest rate and security interest in the assets that comprise Avinza® and certain of the proceeds of Ligand's sale of certain assets. On January 8, 2007, Ligand repaid the principal amount of the loan of \$37,750 and accrued interest of \$883. Pursuant to the terms of the loan agreement with Ligand, the Company forgave the interest on the loan and repaid Ligand the interest at the time of closing the transaction to acquire Avinza®. Accordingly, the Company has not recognized interest income on the related note receivable.

The allocation of the initial purchase price and acquisition costs is as follows:

Intangible assets	\$ 285,700
Goodwill	7,894
Inventory	2,800
	\$ 296,394

At the time of the acquisition, the intangible assets were assigned useful lives of 10.75 years. The acquisition is allocated to the branded pharmaceuticals segment. The goodwill recognized in this transaction is expected to be fully deductible for tax purposes. The Company financed the acquisition using available cash on hand.

On January 9, 2007, the Company obtained an exclusive license to certain hemostatic products owned by Vascular Solutions, Inc. (Vascular Solutions), including products which the Company markets as Thrombi-Paste™ and Thrombi-Gel®. The license also includes a product the Company expects to market as Thrombi-Paste™, which is currently in development. Each of these products includes the Company's Thrombin-JMI topical hemostatic agent product as a component. Vascular Solutions will manufacture the products for the Company. Upon acquisition of the

license, the Company made an initial payment to Vascular Solutions of \$6,000, a portion of which is refundable in the event FDA approval for certain of these products is not received. During the second quarter of 2007, the Company made an additional milestone payment of \$1,000. In addition, the Company could make additional milestone payments of up to a total of \$1,000.

On March 1, 2006, the Company acquired the exclusive right to market and sell EpiPen® throughout Canada and other specific assets from AllereX Laboratory LTD. Under the terms of the agreements, the initial purchase price was \$23,924, plus acquisition costs of \$682. As an additional component of the purchase price, the Company will pay AllereX an earn-out equal to a percentage of future sales of EpiPen® in Canada over a

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

fixed period of time. As these additional payments accrue, the Company will increase intangible assets by the amount of the accrual. As of June 30, 2007, the Company has accrued a total of \$3,641 for these earn-out payments. The aggregate of these payments will not exceed \$13,164.

The allocation of the initial purchase price and acquisition costs is as follows:

Intangible assets	\$ 23,985
Inventory	618
Fixed assets	3
	\$ 24,606

At the time of the acquisition, the intangible assets were assigned useful lives of 9.8 years. The acquisition is allocated to the Meridian Medical Technologies segment. The Company financed the acquisition using available cash on hand.

On February 12, 2006, the Company entered into a collaboration with Arrow International Limited and certain of its affiliates, excluding Cobalt Pharmaceuticals, Inc. (collectively, Arrow), to commercialize one or more novel formulations of ramipril, the active ingredient in the Company's Altac® product. Under a series of agreements, Arrow has granted King rights to certain current and future New Drug Applications regarding novel formulations of ramipril and intellectual property, including patent rights and technology licenses relating to these novel formulations. Arrow will have responsibility for the manufacture and supply of the new formulations of ramipril for King. However, under certain conditions King may manufacture and supply the formulations of ramipril.

Upon execution of the agreements, King made an initial payment to Arrow of \$35,000. During the fourth quarter of 2006 and the first quarter and second quarters of 2007, the Company made additional payments of \$25,000 in each of the three quarters to Arrow. Additionally, Arrow will earn fees for the manufacture and supply of the new formulations of ramipril.

In connection with the agreement with Arrow, the Company recognized the above payments and future payments totaling \$110,000 as in-process research and development expense during 2006. This amount was expensed as in-process research and development as the project had not received regulatory approval and had no alternative future use. The in-process research and development project is part of the branded pharmaceutical segment. This project includes a New Drug Application (NDA) filed by Arrow for a tablet formulation of ramipril in January 2006 (the Ramipril Application). At the time of the acquisition, the success of the project was dependent on additional development activities and FDA approval. The estimated cost to complete the project at the execution of the agreement was approximately \$3,500. The FDA approved the Ramipril Application on February 27, 2007. Arrow granted the Company an exclusive option to acquire their entire right, title and interest to the Ramipril Application or any future filed Amended Ramipril Application for the amount of \$5,000. In April 2007, the Company exercised its option and paid \$5,000 to Arrow. As a result, the Company owns the entire right, title and interest in and to the Ramipril Application. The Company expects to launch the tablet formulation during the fourth quarter of 2007 or the first quarter of 2008.

On February 12, 2006, the Company entered into an agreement with Cobalt Pharmaceuticals, Inc. (Cobalt), an affiliate of Arrow International Limited, whereby Cobalt has the non-exclusive right to distribute a generic formulation of the Company s currently marketed Altac[®] product in the U.S. market, which generic product would be supplied by King.

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Intangible Assets and Goodwill**

The following table reflects the components of intangible assets as of:

	June 30, 2007		December 31, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Trademarks and product rights	\$ 1,035,112	\$ 370,132	\$ 1,056,991	\$ 337,046
Patents	558,421	221,000	272,833	202,873
Other intangibles	7,700	7,398	7,700	7,292
Total intangible assets	\$ 1,601,233	\$ 598,530	\$ 1,337,524	\$ 547,211

Amortization expense for the three months ended June 30, 2007 and 2006 was \$29,527 and \$26,671, respectively. Amortization expense for the six months ended June 30, 2007 and 2006 was \$54,295 and \$52,544, respectively.

During the second quarter of 2007, the Company made the decision to no longer pursue the development of a new formulation of Intal[®] utilizing hydroflouroalkane (HFA) as a propellant. As a result, the Company lowered its future sales forecast for this product in the second quarter of 2007 and decreased the estimated remaining useful life of the product. This decrease reduced the estimated undiscounted future cash flows associated with the Intal[®] and Tilade[®] intangible assets to a level below their carrying value. Accordingly, the Company recorded an intangible asset impairment charge of \$29,259 during the second quarter of 2007 to adjust the carrying value of Intal[®] and Tilade[®] intangible assets on the Company's balance sheet to reflect the estimated fair value of these assets. The Company determined the fair value of the intangible assets associated with Intal[®] and Tilade[®] based on estimated discounted future cash flows. Intal[®] and Tilade[®] are included in the Company's branded pharmaceuticals reporting segment.

As of June 30, 2007, the net intangible assets associated with Synercid[®] totaled approximately \$81,118. The Company believes that these intangible assets are not currently impaired based on estimated undiscounted cash flows associated with these assets. However, if the Company's estimates regarding future cash flows prove to be incorrect or adversely change, the Company may have to reduce the estimated remaining useful life and/or write off a portion or all of these intangible assets.

Goodwill at June 30, 2007 and December 31, 2006 is as follows:

	Branded Segment	Meridian Segment	Total
Goodwill at June 30, 2007	\$ 20,636	\$ 108,410	\$ 129,046
Goodwill at December 31, 2006	\$ 12,742	\$ 108,410	\$ 121,152

6. Assets Held for Sale

In the second quarter of 2007, the Company classified its Rochester, Michigan sterile manufacturing facility and certain legacy branded pharmaceutical products as held for sale. As a result, the Company recorded a charge of \$45,551 based on the assets' fair value less cost to sell.

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

The assets classified as held for sale consist of the following:

	June 30, 2007	December 31, 2006
Accounts receivable, net	\$ 982	\$ 1,528
Inventories	14,620	12,881
Total current assets held for sale	\$ 15,602	\$ 14,409
Property, plant and equipment	\$ 60,279	\$ 62,654
Intangible assets	58,101	61,078
Allowance to reduce noncurrent assets to estimated fair value less cost to sell	(45,551)	
Noncurrent assets held for sale	\$ 72,829	\$ 123,732

On July 14, 2007, the Company entered into an asset purchase agreement with JHP, pursuant to which JHP will acquire the Company's Rochester, Michigan sterile manufacturing facility, some of the Company's legacy products that are manufactured there, and the related contract manufacturing business. The Company will retain its Bicillin® (sterile penicillin products) manufacturing facility which is also located in Rochester Michigan.

Under the terms of the asset purchase agreement, JHP will pay the Company approximately \$90,000 subject to final inventory adjustments. The agreement is subject to customary regulatory approvals, including antitrust review under the Hart-Scott-Rodino Antitrust Improvements Act. The companies also entered into a manufacturing and supply agreement pursuant to which JHP will provide certain fill and finish manufacturing activities with respect to the Company's hemostatic product, Thrombin-JM® (thrombin, topical, bovine, USP). The companies expect to close the transaction during the third quarter of 2007.

7. Long-Term Debt

Long-term debt consists of the following:

	June 30, 2007	December 31, 2006
Convertible senior notes	\$ 400,000	\$ 400,000
Senior secured revolving credit facility(a)		
Long-term portion	\$ 400,000	\$ 400,000

- (a) On April 23, 2002, the Company established a \$400,000 five-year Senior Secured Revolving Credit Facility which was scheduled to mature in April 2007 (the 2002 Credit Facility). On April 19, 2007, this facility was terminated and replaced with a new \$475,000 five-year Senior Secured Revolving Credit Facility which matures in April 2012 (the 2007 Credit Facility).

The 2007 Credit Facility is collateralized by a pledge of 100% of the equity of most of the Company's domestic subsidiaries and by a pledge of 65% of the equity of the Company's foreign subsidiaries. The Company's obligations under this facility are unconditionally guaranteed on a senior basis by four of the Company's subsidiaries, King Pharmaceuticals Research and Development, Inc., Monarch Pharmaceuticals, Inc., Meridian Medical Technologies, Inc., and Parkedale Pharmaceuticals, Inc.

The 2007 Credit Facility accrues interest at either, at the Company's option, (a) the base rate, which is based on the greater of (1) the prime rate or (2) the federal funds rate plus one-half of 1%, plus an applicable spread ranging from 0.0% to 0.5% (based on a leverage ratio), or (b) the applicable LIBOR rate plus an applicable spread ranging from 0.875% to 1.50% (based on a leverage ratio). In addition, the lenders

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

under the 2007 Credit Facility are entitled to customary facility fees based on (a) unused commitments under the facility and (b) letters of credit outstanding. The facility provides availability for the issuance of up to \$30,000 in letters of credit. The Company incurred \$1,623 of deferred financing costs in connection with the establishment of this facility, which the Company will amortize over five years, the life of the facility. This facility requires the Company to maintain a minimum net worth of no less than \$1,500,000 plus 50% of the Company's consolidated net income for each fiscal quarter after April 19, 2007, excluding any fiscal quarter for which consolidated income is negative; an EBITDA (earnings before interest, taxes, depreciation and amortization) to interest expense ratio of no less than 3.00 to 1.00; and a funded debt to EBITDA ratio of no greater than 3.50 to 1.00.

8. Commitments and Contingencies

Fen/Phen Litigation

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

The Company's wholly-owned subsidiary, King Pharmaceuticals Research and Development, Inc. (King Research and Development), is a defendant in approximately 92 multi-plaintiff (1,443 plaintiffs) lawsuits involving the manufacture and sale of dexfenfluramine, fenfluramine and phentermine. These lawsuits have been filed in various jurisdictions throughout the United States and in each of these lawsuits King Research and Development, as the successor to Jones Pharma Incorporated (Jones), is one of many defendants, including manufacturers and other distributors of these drugs. Although Jones did not at any time manufacture dexfenfluramine, fenfluramine, or phentermine, Jones was a distributor of a generic phentermine product and, after its acquisition of Abana Pharmaceuticals, was a distributor of Obenix®, Abana's branded phentermine product. The manufacturer of the phentermine purchased by Jones filed for bankruptcy protection and is no longer in business. The plaintiffs in these cases, in addition to the claims described above, claim injury as a result of ingesting a combination of these weight-loss drugs and are seeking compensatory and punitive damages as well as medical care and court-supervised medical monitoring. The plaintiffs claim liability based on a variety of theories, including, but not limited to, product liability, strict liability, negligence, breach of warranty, fraud and misrepresentation.

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

While the Company cannot predict the outcome of these lawsuits, management believes that the claims against King Research and Development are without merit and intends to vigorously pursue all defenses available. The Company is unable to disclose an aggregate dollar amount of damages claimed because many of these complaints are multi-party suits and do not state specific damage amounts. Rather, these claims

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

typically state damages as may be determined by the court or similar language and state no specific amount of damages against King Research and Development. Consequently, the Company cannot reasonably estimate possible losses related to the lawsuits.

In addition, the Company is one of many defendants in six multi-plaintiff lawsuits that claim damages for personal injury arising from its production of the anorexigenic drug phentermine under contract for GlaxoSmithKline. While the Company cannot predict the outcome of these suits, the Company believes that the claims against it are without merit and the Company intends to pursue all defenses available to it. The Company is being indemnified in the six lawsuits by GlaxoSmithKline, for which the Company manufactured the anorexigenic product, provided that neither the lawsuits nor the associated liabilities are based upon the Company's independent negligence or intentional acts. The Company intends to submit a claim for any unreimbursed costs to its product liability insurance carrier. However, in the event that GlaxoSmithKline is unable to satisfy or fulfill its obligations under the indemnity, the Company would have to assume defense of the lawsuits and be responsible for damages, fees and expenses, if any, that are awarded against it or for amounts in excess of the Company's product liability coverage. A reasonable estimate of possible losses related to these suits cannot be made.

Thimerosal / Children's Vaccine Related Litigation

The Company and Parkedale Pharmaceuticals, Inc., a wholly-owned subsidiary of the Company (Parkdale), were named as defendants in lawsuits filed in California, Mississippi and Illinois (Madison County), along with other pharmaceutical companies. The first of these lawsuits was filed in November 2001. Most of the defendants manufactured or sold the mercury-based preservative thimerosal or manufactured or sold children's vaccines containing thimerosal. The Company did not manufacture or sell thimerosal or a children's vaccine that contained thimerosal. For two years the Company did manufacture and sell an influenza vaccine that contained thimerosal. None of the plaintiffs alleged taking the Company's influenza vaccine.

All claims against the Company and Parkedale in the children's vaccine litigation have been voluntarily dismissed without prejudice due, among other matters, to lack of product identification. These claims were dismissed without the payment of any settlement proceeds. Although these claims could be filed again, the Company does not believe that re-filing is likely.

Hormone Replacement Therapy

Currently, the Company is named as a defendant by 22 plaintiffs in lawsuits involving the manufacture and sale of hormone replacement therapy drugs. The first of these lawsuits was filed in July 2004. Numerous other pharmaceutical companies have also been sued. The Company was sued by approximately 800 plaintiffs, but most of those claims were voluntarily dismissed or dismissed by the Court for lack of product identification. These remaining 22 lawsuits were filed in Alabama, Arkansas, Missouri, Pennsylvania, Ohio, Florida, Maryland, Mississippi and Minnesota. A federal multidistrict litigation court (MDL) has been established in Little Rock, Arkansas, *In re: Prempro Products Liability Litigation*, and all of the plaintiffs' claims have been transferred and are pending in that Court except for one lawsuit pending in Philadelphia, Pennsylvania State Court. Many of these plaintiffs allege that the Company and other defendants failed to conduct adequate research and testing before the sale of the products and post-sale monitoring to establish the safety and efficacy of the long-term hormone therapy regimen and, as a result, misled consumers when marketing their products. Plaintiffs also allege negligence, strict liability, design defect, breach of implied warranty, breach of express warranty, fraud and misrepresentation. Discovery of the plaintiffs' claims against the Company has begun but is limited to document discovery. No trial has occurred in the hormone

replacement therapy litigation against the Company or any other defendants except Wyeth and Pfizer. The first several trials against Wyeth have resulted in one mistrial for juror misconduct, three verdicts for Wyeth in the MDL and two plaintiffs' verdicts for \$1,500 and \$3,000, in Philadelphia, Pennsylvania State Court, one of

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

which was subsequently reversed on post-trial motions. Pfizer's only trial, in Philadelphia, Pennsylvania, resulted in a plaintiff's verdict for \$1,500. The Company does not expect to have any trials set in the next year. The Company intends to defend these lawsuits vigorously but is currently unable to predict the outcome or to reasonably estimate the range of potential loss, if any. The Company may have limited insurance for these claims. The Company would have to assume defense of the lawsuits and be responsible for damages, fees and expenses, if any, that are awarded against it or for amounts in excess of the Company's product liability coverage.

Average Wholesale Price Litigation

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

Since the filing of the New York City case, forty eight New York counties have filed lawsuits against the pharmaceutical industry, including the Company and Monarch. All of these lawsuits are currently pending in the MDL Court in the District of Massachusetts. Motions to remand were filed in the Erie, Oswego and Schenectady cases after they were removed from the New York State Courts. The allegations in all of these cases are virtually the same as the allegations in the New York City case. A First Amended Consolidated Complaint was filed for most of the New York counties. Motions to dismiss were granted in part and denied in part for all defendants in all New York City and County cases pending in the MDL except for the Orange, Oswego and Schenectady cases. The Erie motion to dismiss was granted in part and denied in part by the state court before removal. The MDL Court has not ruled on the motions to remand Erie, Oswego and Schenectady Counties' claims. It is expected that the Orange County claims will be merged with the First Amended Consolidated Complaint for the New York counties.

In January 2005, the State of Alabama filed a lawsuit in State Court against 79 defendants including the Company and Monarch. The four causes of action center on the allegation that all defendants fraudulently inflated AWP's of their products. A motion to dismiss was filed and denied by the court, but the Court did require an amended complaint to be filed. The Company filed an answer and counter-claim for return of rebates overpaid to the State. Alabama filed a motion to dismiss the counter-claim which was granted. The Company perfected its appeal of that ruling. Briefing in the appeal to the Alabama Supreme Court has been completed. No oral argument date has been set. In a separate appeal of a motion to sever denied by the Court, the Alabama Supreme Court severed all defendants into single-defendant cases.

In October 2005, the State of Mississippi filed a lawsuit in State Court against the Company, Monarch and eighty-four other defendants and alleged fourteen causes of action. Many of those causes of action allege that all defendants fraudulently inflated the AWP's and wholesale acquisition costs (WACs) of their products. A motion to dismiss the criminal statute counts and a motion for more definite statement were granted. Mississippi was required to file an amended complaint and in doing so dismissed the Company and Monarch from the lawsuit without prejudice. These claims could be refiled.

A co-defendant removed the Alabama and Mississippi cases to Federal Court on October 11, 2006. The Alabama case was remanded to State Court on November 2, 2006. The MDL Court has not ruled upon the motion to remand the Mississippi case from which we were previously dismissed. Discovery is proceeding in

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Alabama case for some defendants, not including the Company, and is expected to conclude at the end of August 2007. The relief sought in both of these cases is similar to the relief sought in the New York City lawsuit. The Company does not expect any of its trials to be set in the next year. The Company intends to defend all of the AWP lawsuits vigorously but is currently unable to predict the outcome or reasonably estimate the range of potential loss, if any.

Settlement of Governmental Pricing Investigation

As previously reported, during the first quarter of 2006, the Company paid approximately \$129,268, comprising (i) all amounts due under each of the settlement agreements resolving the governmental investigations related to the Company's underpayment of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002 (the Settlement Agreements) and (ii) all the Company's obligations to reimburse other parties for expenses related to the settlement, including the previously disclosed legal fees of approximately \$787 and the previously disclosed settlement costs of approximately \$950.

The individual purportedly acting as a relator under the False Claims Act has appealed certain decisions of the District Court denying the relator's request to be compensated out of the approximately \$31,000 that was paid by the Company to those states that do not have legislation providing for a relator's share. The purported relator asserted for the first time on appeal that the Company should be responsible for making such a payment to this individual. Oral argument of the appeal before the United States Court of Appeals for the Third Circuit was heard on May 8, 2007. On July 16, 2007, the Court of Appeals affirmed the District Court's decision in all respects, and denied the relator's assertions with respect to the Company. The relator has exercised his limited rights to appeal the Court of Appeals' decision. The Company believes that the claim against it is without merit and does not expect the result of this appeal or any subsequent appeal to have a material effect on it.

In addition to the Settlement Agreements, on October 31, 2005, the Company entered into a five-year corporate integrity agreement with HHS/OIG (the Corporate Integrity Agreement) pursuant to which the Company is required, among other things, to keep in place the Company's current compliance program, to provide periodic reports to HHS/OIG and to submit to audits relating to the Company's Medicaid rebate calculations.

The Settlement Agreements do not resolve any of the previously disclosed civil suits that are pending against the Company and related individuals and entities discussed in the section "Securities and Derivative Litigation" below.

SEC Investigation

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

The Company continues to cooperate with the SEC's ongoing investigation. Based on all information currently available to it, the Company does not anticipate that the results of the SEC's ongoing investigation will have a material adverse effect on it, including by virtue of any obligations to indemnify current or former officers and directors.

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Securities and Derivative Litigation

Subsequent to the announcement of the SEC investigation described above, beginning in March 2003, 22 purported class action complaints were filed by holders of the Company's securities against the Company, its directors, former directors, executive officers, former executive officers, a Company subsidiary, and a former director of the subsidiary in the United States District Court for the Eastern District of Tennessee, alleging violations of the Securities Act of 1933 and/or the Securities Exchange Act of 1934, in connection with the Company's underpayment of rebates owed to Medicaid and other governmental pricing programs, and certain transactions between the Company and the Benevolent Fund, a nonprofit organization affiliated with certain former members of the Company's senior management. These 22 complaints were consolidated in the United States District Court for the Eastern District of Tennessee. In addition, holders of the Company's securities filed two class action complaints alleging violations of the Securities Act of 1933 in Tennessee State Court. The Company removed these two cases to the United States District Court for the Eastern District of Tennessee, where these two cases were consolidated with the other class actions.

In November 2005, the parties agreed to submit the matter to non-binding mediation. After an extensive mediation process, an agreement in principle to settle the litigation was reached on April 26, 2006. On July 31, 2006, the parties entered into a stipulation of settlement and a supplemental agreement (together, the Settlement Agreement) to resolve the litigation. On January 9, 2007, the Court granted final approval of the Settlement Agreement. The Settlement Agreement provides for a settlement amount of \$38,250 which has been fully funded by the Company's insurance carriers on the Company's behalf and placed into an escrow account controlled by the Court.

Beginning in March 2003, four purported shareholder derivative complaints were also filed in Tennessee State Court alleging a breach of fiduciary duty, among other things, by some of the Company's current and former officers and directors, with respect to the same events at issue in the federal securities litigation described above. These cases have been consolidated. In June 2007, plaintiffs filed a motion to amend the complaint, seeking to name as defendants additional current and former officers and directors and the Company's independent auditors and to add additional claims. Trial is scheduled to begin on September 22, 2008.

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

During the third quarter of 2006 and the second quarter of 2007, the Company recorded an anticipated insurance recovery of legal fees in the amount of \$6,750 and \$3,398, respectively, for the class action and derivative suits described above. In November of 2006 and July of 2007, the Company received payment for the recovery of these legal fees.

The Company is currently unable to predict the outcome or reasonably estimate the range of potential loss, if any, except as noted above, in the pending litigation. If the Company were not to prevail in the pending litigation, which it cannot predict or reasonably estimate at this time, its business, financial condition, results of operations and cash flows could be materially adversely affected.

Other Legal Proceedings

Elan Corporation, plc (Elan) was working to develop a modified release formulation of Sonata[®] which the Company refers to as Sonata[®] MR, pursuant to an agreement the Company had with Elan which the Company refers to as the Sonata[®] MR Development Agreement. In early 2005, the Company advised Elan that it considered the Sonata[®] MR Development Agreement terminated for failure to satisfy the target product

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

profile required by the Company. Elan disputed the termination and initiated an arbitration proceeding. During December of 2006, the arbitration panel reached a decision in favor of Elan and ordered the Company to pay Elan certain milestone payments and other research and development related expenses of approximately \$49,800, plus interest from the date of the decision. The Company recorded approximately \$45,100 in the fourth quarter of 2006 and had previously recorded \$5,000 in 2004, related to this arbitration. In January 2007, the Company paid Elan approximately \$50,100, which included interest of approximately \$300.

Cobalt Pharmaceuticals, Inc. (Cobalt), a generic drug manufacturer located in Mississauga, Ontario, Canada, filed an Abbreviated New Drug Application (ANDA) with the U.S. Food and Drug Administration (the FDA) seeking permission to market a generic version of Altace®. The following U.S. patents are listed for Altace® in the FDA's *Approved Drug Products With Therapeutic Equivalence Evaluations* (the Orange Book): United States Patent No. 5,061,722 (the 722 patent), a composition of matter patent, and United States Patent No. 5,403,856 (the 856 patent), a method-of-use patent, with expiration dates of October 2008 and April 2012, respectively. Under the federal Hatch-Waxman Act of 1984, any generic manufacturer may file an ANDA with a certification (a Paragraph IV certification) challenging the validity or infringement of a patent listed in the FDA's Orange Book four years after the pioneer company obtains approval of its New Drug Application (NDA). Cobalt filed a Paragraph IV certification alleging invalidity of the 722 patent, and Aventis Pharma Deutschland GmbH (Aventis) and the Company filed suit on March 14, 2003 in the District Court for the District of Massachusetts to enforce the rights under that patent. Pursuant to the Hatch-Waxman Act, the filing of that suit provided the Company an automatic stay of FDA approval of Cobalt's ANDA for 30 months (unless the patents are held invalid, unenforceable, or not infringed) from no earlier than February 5, 2003. That 30-month stay expired in August 2005 and on October 24, 2005, the FDA granted final approval of Cobalt's ANDA. In March 2004, Cobalt stipulated to infringement of the 722 patent. Subsequent to filing its original complaint, the Company amended its complaint to add an allegation of infringement of the 856 patent. The 856 patent covers one of Altace's three indications for use. In response to the amended complaint, Cobalt informed the FDA that it no longer seeks approval to market its proposed product for the indication covered by the 856 patent. On this basis, the Court granted Cobalt summary judgment of non-infringement of the 856 patent. The Court's decision does not affect Cobalt's infringement of the 722 patent. The parties submitted a joint stipulation of dismissal on April 4, 2006, and the Court granted dismissal.

The Company has received a civil investigative demand (CID) for information from the U.S. Federal Trade Commission (FTC). The CID requires the Company to provide information related to the Company's collaboration with Arrow, the dismissal without prejudice of the Company's patent infringement litigation against Cobalt under the Hatch-Waxman Act of 1984 and other information. The Company is cooperating with the FTC in this investigation.

Lupin Ltd. (Lupin) filed an ANDA with the FDA seeking permission to market a generic version of Altace® (Lupin's ANDA). In addition to its ANDA, Lupin filed a Paragraph IV certification challenging the validity and infringement of the 722 patent, and seeking to market its generic version of Altace® before expiration of the 722 patent. In July 2005, the Company filed civil actions for infringement of the 722 patent against Lupin in the U.S. District Courts for the District of Maryland and the Eastern District of Virginia. Pursuant to the Hatch-Waxman Act, the filing of the lawsuit against Lupin provided the Company with an automatic stay of FDA approval of Lupin's ANDA for up to 30 months (unless the patents are held invalid, unenforceable, or not infringed) from no earlier than June 8, 2005. On February 1, 2006, the Maryland and Virginia cases were consolidated into a single action in the Eastern District of Virginia. On June 5, 2006, the Court granted King summary judgment and found Lupin to infringe the 722 patent. On June 14, 2006, during the trial, the Court dismissed Lupin's unenforceability claims as a matter of law, finding the 722 patent enforceable. On July 18, 2006, the Court upheld the validity of the 722 patent. Lupin filed a notice of appeal on July 19, 2006. All appellate briefing was completed as of March 19, 2007, and the Court heard oral arguments on

July 12, 2007.

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company intends to vigorously enforce its rights under the 722 and 856 patents. As of June 30, 2007, the Company had net intangible assets related to Altace® of \$213,376. If a generic version of Altace® enters the market sooner than the Company anticipates, the Company may have to write off a portion or all of the intangible assets associated with this product, and the Company's business, financial condition, results of operations and cash flows could otherwise be materially adversely affected.

Eon Labs, Inc. (Eon Labs), CorePharma, LLC (CorePharma) and Mutual Pharmaceutical Co., Inc. (Mutual) have each filed an ANDA with the FDA seeking permission to market a generic version of Skelaxin® 400 mg tablets. Additionally, Eon Labs' ANDA seeks permission to market a generic version of Skelaxin® 800 mg tablets. United States Patent Nos. 6,407,128 (the 128 patent) and 6,683,102 (the 102 patent), two method-of-use patents relating to Skelaxin®, are listed in the FDA's Orange Book and do not expire until December 3, 2021. Eon Labs and CorePharma each filed Paragraph IV certifications against the 128 and 102 patents, and are alleging noninfringement, invalidity and unenforceability of those patents. Mutual has filed a Paragraph IV certification against the 102 patent alleging noninfringement and invalidity of that patent. A patent infringement suit was filed against Eon Labs on January 2, 2003 in the District Court for the Eastern District of New York; against CorePharma on March 7, 2003 in the District Court for the District of New Jersey (subsequently transferred to the District Court for the Eastern District of New York); and against Mutual on March 12, 2004 in the District Court for the Eastern District of Pennsylvania concerning their proposed 400 mg products. Additionally, the Company filed a separate suit against Eon Labs on December 17, 2004 in the District Court for the Eastern District of New York, concerning its proposed 800 mg Skelaxin® product.

Pursuant to the Hatch-Waxman Act, the filing of the suit against CorePharma triggered an automatic stay of FDA approval of CorePharma's ANDA for 30 months (unless the patents are held invalid, unenforceable, or not infringed) from no earlier than January 24, 2003. Also pursuant to the Hatch-Waxman Act, the filing of the suits against Eon Labs provided the Company with an automatic stay of FDA approval of Eon Labs' ANDA for its proposed 400 mg and 800 mg products for 30 months (unless the patents are held invalid, unenforceable, or not infringed) from no earlier than November 18, 2002 and November 3, 2004, respectively. The 30-month stay of FDA approval for Eon Labs' ANDA for its proposed 400 mg product expired in May 2005. The 30-month stay of FDA approval for Eon Labs' 800 mg product was tolled by the Court and has not expired yet. The Court has reserved judgment on the length of the tolling period. On May 17, 2006, the District Court for the Eastern District of Pennsylvania placed the Mutual case on the Civil Suspense Calendar pending the outcome of the FDA activity described below. On June 16, 2006, the District Court for the Eastern District of New York consolidated the Eon Labs cases with the CorePharma case. On April 30, 2007, Eon Labs' 400 mg case was dismissed without prejudice, although Eon Labs' claim for fees and expenses was severed and consolidated with Eon Labs' 800 mg case. The Court also set a briefing schedule in the CorePharma case for the Company's motion to dismiss for lack of case or controversy and for a CorePharma motion for summary judgment of non-infringement. The motions were fully briefed by July 2007 and oral argument is set for August 2007. The Company intends to vigorously enforce its rights under the 128 and 102 patents to the full extent of the law.

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

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On March 12, 2004, the FDA sent a letter to the Company explaining that its proposed labeling revision for Skelaxin[®], which includes references to additional clinical studies relating to food, age, and gender effects, was approvable and only required certain formatting changes. On April 5, 2004, the Company submitted amended labeling text that incorporated those changes. On April 5, 2004, Mutual filed a petition for stay of action requesting the FDA to stay approval of the Company's proposed labeling revision until the FDA has fully evaluated and ruled upon the Company's Citizen Petition, as well as all comments submitted in response to that petition. The Company, CorePharma and Mutual have filed responses and supplements to their pending Citizen Petitions and responses. On December 8, 2005, Mutual filed another supplement with the FDA in which it withdrew its prior petition for stay, supplement, and opposition to the Company's Citizen Petition. On November 24, 2006, the FDA approved the revision to the Skelaxin[®] labeling. On February 13, 2007, the Company filed another supplement to the Company's Citizen Petition to reflect FDA approval of the revision to the Skelaxin[®] labeling. On May 2, 2007, Mutual filed comments in connection with the Company's supplemental submission.

If the Company's Amended Citizen Petition is rejected, there is a substantial likelihood that a generic version of Skelaxin[®] will enter the market, and the Company's business, financial condition, results of operations and cash flows could be materially adversely affected. As of June 30, 2007, the Company had net intangible assets related to Skelaxin[®] of \$147,062. If demand for Skelaxin[®] declines below current expectations, the Company may have to write off a portion or all of these intangible assets.

The Company has entered into an agreement with a generic pharmaceutical company to launch an authorized generic version of Skelaxin[®] in the event the Company faces generic competition for Skelaxin[®]. However, the Company cannot provide any assurance regarding the extent to which this strategy will be successful, if at all.

Sicor Pharmaceuticals, Inc. (Sicor Pharma), a generic drug manufacturer located in Irvine California, filed an ANDA with the FDA seeking permission to market a generic version of Adenoscan[®]. U.S. Patent No. 5,070,877 (the 877 patent), a method-of-use patent with an expiration date of May 2009, is assigned to the Company and listed in the FDA's Orange Book entry for Adenoscan[®]. Astellas Pharma US, Inc. (Astellas) is the exclusive licensee of certain rights under the 877 patent and has marketed Adenoscan[®] in the U.S. since 1995. A substantial portion of the Company's revenues from its royalties segment is derived from Astellas based on its net sales of Adenoscan[®]. Sicor Pharma has filed a Paragraph IV certification alleging invalidity of the 877 patent and non-infringement of certain claims of the 877 patent. The Company and Astellas filed suit against Sicor Pharma and its parents/affiliates Sicor, Inc., Teva Pharmaceuticals USA, Inc. (Teva) and Teva Pharmaceutical Industries, Ltd., on May 26, 2005 in the United States District Court for the District of Delaware to enforce their rights under the 877 patent. Pursuant to the Hatch-Waxman Act, the filing of that suit provided the Company an automatic stay of FDA approval of Sicor Pharma's ANDA for 30 months (unless the patents are held invalid, unenforceable, or not infringed) from no earlier than April 16, 2005. On May 16, 2006, Sicor Pharma stipulated to infringement of the asserted claims of the 877 patent. Trial in this action began on February 12, 2007 and concluded on February 28, 2007. Post-trial briefing concluded in June 2007. The Company intends to vigorously enforce its rights under the 877 patent. Sicor is also involved in litigation with Item Development AB regarding U.S. Patent No. 5,731,296 (the 296 patent), a method-of-use patent with an expiration date of March 2015, which is also listed in the Orange Book for Adenoscan[®]. Trial of the 296 patent occurred simultaneously with the 877 patent. Post-trial briefing for the 296 patent trial followed the same schedule as the 877 patent trial. Entry by Teva's adenosine generic product is contingent upon its defeating both the 296 and 877 patents. If a generic version of Adenoscan[®] enters the market or competitive products enter the market, the Company's business, financial condition, results of operations and cash flows could be materially adversely affected.

Teva filed an ANDA with the FDA seeking permission to market a generic version of Sonata®. In addition to its ANDA, Teva filed a Paragraph IV certification challenging the enforceability of U.S. Patent 4,626,538

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(the '538 patent) listed in the Orange Book, a composition of matter patent which expires in June 2008. In August 2005, King filed suit against Teva in the United States District Court for the District of New Jersey to enforce its rights under the '538 patent. Pursuant to the Hatch-Waxman Act, the filing of that suit provided the Company an automatic stay of FDA approval of Teva's ANDA for 30 months (unless the patents are held invalid, unenforceable, or not infringed) from no earlier than June 21, 2005. On September 25, 2006, the parties filed a stipulation with the Court in which Teva admitted infringement of the '538 patent. In October 2006, Teva filed a summary judgment motion on the grounds that the '538 patent is unenforceable due to breach in the common ownership requirement for terminally disclaimed patents. The Company filed its opposition brief in November 2006. Oral argument was heard on January 10, 2007, and the Court subsequently denied Teva's summary judgment motion. The Company has filed a motion for summary judgment to dispose of the case, and Teva filed a cross-motion for summary judgment. The Company intends to vigorously enforce its rights under the '538 patent. As of June 30, 2007, the Company had no net intangible assets related to Sonata[®]. If a generic form of Sonata[®] enters the market, the Company's business, financial condition, results of operations and cash flows could be materially adversely affected.

In addition to the matters discussed above, the Company is involved in various other legal proceedings incident to the ordinary course of its business. The Company does not believe that unfavorable outcomes as a result of these other legal proceedings would have a material adverse effect on its financial position, results of operations and cash flows.

Other Contingencies

The Company has a supply agreement with a third party to produce ramipril, the active ingredient in Altace[®]. This supply agreement requires the Company to purchase certain minimum levels of ramipril as long as the Company maintains market exclusivity for Altace[®] in the United States, and thereafter the parties must negotiate in good faith the annual minimum purchase quantities. If the Company is unable to maintain market exclusivity for Altace[®] in accordance with current expectations and/or if the Company's product life cycle management is not successful, the Company may incur losses in connection with the purchase commitments under the supply agreement. In the event the Company incurs losses in connection with the purchase commitments under the supply agreement, there may be a material adverse effect upon the Company's results of operations and cash flows.

The Company has supply agreements with two third parties to produce metaxalone, the active ingredient in Skelaxin[®]. These supply agreements require the Company to purchase certain minimum levels of metaxalone and expire in 2008 and 2010. If sales of Skelaxin[®] are not consistent with current forecasts, the Company could incur losses in connection with purchase commitments for metaxalone, which could have a material adverse effect upon the Company's results of operations and cash flows.

9. Accounting Developments

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is in the process of evaluating the effect of SFAS No. 157 on its financial statements and is planning to adopt this standard in the first quarter of 2008.

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*, that seeks to reduce the variability in practice associated with measurement and recognition of tax benefits. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a more likely than not threshold. The Company recorded the cumulative effect of applying FIN 48 of \$1,523 as a reduction to the opening balance of retained earnings. The total net liability under FIN 48 as of January 1, 2007 was \$34,152. See Note 10, Income Taxes, for additional information.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is in the process of evaluating the effect of SFAS No. 159 on its financial statements and is planning to adopt this standard in the first quarter of 2008.

10. Income Taxes

The Company's effective income tax rate varied from the statutory rate for the three and six months ended June 30, 2007 primarily due to tax benefits related to tax-exempt interest income and domestic production activities deductions, which benefits were partially offset by state taxes. The Company's effective tax rate varied from the statutory rate for the three and six months ended June 30, 2006 primarily due to tax benefits related to charitable contributions of inventory, tax-exempt interest income, and domestic production activities deductions, which benefits were partially offset by state taxes.

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recorded a \$1,523 increase to the net liability for unrecognized tax positions, which was recorded as a reduction to the opening balance of retained earnings as of January 1, 2007. The total liability recorded under FIN 48, as of January 1, 2007, was \$34,152, net of federal tax benefits, including interest and penalties of \$3,147 and \$2,702, respectively.

As of June 30, 2007, the total liability recorded under FIN 48 was \$36,124, net of federal tax benefits. The total amount of unrecognized tax benefits as of June 30, 2007, was \$29,337, all of which would benefit the effective tax rate if recognized. In accordance with its accounting policy, the Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. The Company's Condensed Consolidated Balance Sheet as of June 30, 2007 includes interest and penalties of \$4,033 and \$2,754, respectively.

Included in the balance of unrecognized tax benefits at June 30, 2007, was \$5,792 related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount is comprised primarily of items related to expiring statutes.

As of June 30, 2007, the Company is subject to U.S. Federal income tax examinations for the tax years 2003 through 2006, and to non-U.S. income tax examinations for the tax years of 2002 through 2006. In addition, the Company is subject to state and local income tax examinations for the tax years 2002 through 2006.

11. Segment Information

The Company's business is classified into five reportable segments: branded pharmaceuticals, Meridian Medical Technologies (Meridian), royalties, contract manufacturing and all other. Branded pharmaceuticals includes a variety of branded prescription products that are separately categorized into four therapeutic areas: cardiovascular/metabolic, neuroscience, hospital/acute care, and other. These branded prescription products are

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

aggregated because of the similarity in regulatory environment, manufacturing processes, methods of distribution, and types of customer. Meridian develops, manufactures, and sells to both commercial and government markets pharmaceutical products that are administered with an auto-injector. The principal source of revenues in the commercial market is the EpiPen® product, an epinephrine filled auto-injector which is primarily prescribed for the treatment of severe allergic reactions and which is primarily marketed, distributed and sold by Dey, L.P. Government revenues are principally derived from the sale of nerve agent antidotes and other emergency medicine auto-injector products marketed to the U.S. Department of Defense and other federal, state and local agencies, particularly those involved in homeland security, as well as to approved foreign governments. Contract manufacturing primarily includes pharmaceutical manufacturing services the Company provides to third-party pharmaceutical and biotechnology companies. Royalties include revenues the Company derives from pharmaceutical products after the Company has transferred the manufacturing or marketing rights to third parties in exchange for licensing fees or royalty payments.

The Company primarily evaluates its segments based on segment profit. Reportable segments were separately identified based on revenues, segment profit (excluding depreciation and amortization) and total assets. Revenues among the segments are presented in the individual segments and removed through eliminations in the information below. Substantially all of the eliminations relate to sales from the contract manufacturing segment to the branded pharmaceuticals segment. The Company's revenues are substantially all derived from activities within the United States and Puerto Rico. The Company's assets are substantially all located within the United States and Puerto Rico.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Total revenues:				
Branded pharmaceuticals	\$ 466,931	\$ 419,118	\$ 916,018	\$ 836,738
Meridian Medical Technologies	50,896	53,883	93,911	95,167
Royalties	20,396	21,085	40,720	40,721
Contract manufacturing	158,580	149,909	316,966	271,191
Other	1,053		1,449	
Eliminations	(155,130)	(144,350)	(310,308)	(259,937)
Consolidated total net revenues	\$ 542,726	\$ 499,645	\$ 1,058,756	\$ 983,880
Segment profit:				
Branded pharmaceuticals	\$ 371,172	\$ 343,415	\$ 733,385	\$ 695,644
Meridian Medical Technologies	30,148	30,127	54,723	52,164
Royalties	17,769	18,529	35,650	35,795
Contract manufacturing	165	526	369	825
Other	(2,058)		(2,355)	
Other operating costs and expense	(328,885)	(227,606)	(565,606)	(547,196)
Other income (expense)	6,942	4,829	13,640	8,317

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

Income from continuing operations before tax	\$ 95,253	\$ 169,820	\$ 269,806	\$ 245,549
--	-----------	------------	------------	------------

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

	As of June 30, 2007	As of December 31, 2006
Total assets:		
Branded pharmaceuticals	\$ 2,991,880	\$ 2,994,580
Meridian Medical Technologies	310,230	294,455
Royalties	62,525	21,626
Contract manufacturing	13,710	18,870
Other		
Consolidated total assets	\$ 3,378,345	\$ 3,329,531

The following represents branded pharmaceutical revenues by therapeutic area:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Total revenues:				
Cardiovascular/metabolic	\$ 204,901	\$ 201,138	\$ 399,291	\$ 405,006
Neuroscience	159,448	121,390	304,818	241,283
Hospital/acute care	88,062	83,395	182,992	164,411
Other	14,520	13,195	28,917	26,038
Consolidated branded pharmaceutical revenues	\$ 466,931	\$ 419,118	\$ 916,018	\$ 836,738

12. Restructuring Activities

During 2006, the Company decided to streamline manufacturing activities in order to improve operating efficiency and reduce costs, including the decision to transfer the production of Levoxy[®] from its St. Petersburg, Florida facility to its Bristol, Tennessee facility by the end of 2008. As a result of these steps, the Company expects to incur restructuring charges totaling approximately \$13,000 through the end of 2008, of which approximately \$11,000 is associated with accelerated depreciation and approximately \$2,000 is associated with employee termination costs.

The types of costs accrued and incurred are summarized below:

Accrued	Accrued
Balance at	Balance at
Income	at

	December 31, 2006	Statement Impact	Cash Payments	Non-Cash Costs	June 30, 2007
First quarter of 2007 action					
Employee separation payments	\$	\$ 460	\$	\$	\$ 460
Third quarter of 2006 action					
Employee separation payments	2,163				2,163
Accelerated depreciation(1)		3,000		(3,000)	
Fourth quarter of 2005 action					
Employee separation payments	521				521
	\$ 2,684	\$ 3,460	\$	\$ (3,000)	\$ 3,144

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

The restructuring charges in 2007 relate to the branded pharmaceutical segment. The accrued employee separation payments as of June 30, 2007 are expected to be paid by the end of 2008.

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Marketable Securities

As of June 30, 2007 and December 31, 2006, the Company's investment in Palatin Technologies, Inc. common stock had a cost basis of \$12,242 and there were cumulative unrealized holding losses of \$1,005 and \$664, respectively.

14. Stock-Based Compensation

During the second quarter of 2007, under its Incentive Plan, the Company granted to certain employees 175,600 RSAs, 5,400 LPUs with a three year performance cycle and 17,500 nonqualified stock options. In addition, the Company granted 41,069 Restricted Stock Units (RSUs) to non-employee directors.

During March 2007, under its Incentive Plan, the Company granted to certain employees 179,210 RSAs, 655,840 LPUs with a one year performance cycle, 158,610 LPUs with a three year performance cycle and 352,510 nonqualified stock options.

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

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

The LPUs are rights to receive common stock of the Company in which the number of shares ultimately received depends on the Company's performance over time. LPUs with a one-year performance cycle, followed by a two-year restriction period, will be earned based on 2007 operating targets. LPUs with a three-year performance cycle will be earned based on market-related performance targets over the years 2007 through 2009. At the end of the applicable performance period, the number of shares of common stock awarded is determined by adjusting upward or downward from the performance target in a range between 0% and 200%. The final performance percentage on which the number of shares of common stock issued is based, considering performance metrics established for the performance period, will be determined by the Company's Board of Directors or a committee of the Board at its sole discretion.

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

15. Change in Estimate

The Company's calculation of its product returns reserves is based on historical sales and return rates over the period during which customers have a right of return. The Company also considers current wholesale inventory levels of the Company's products. Because actual returns related to sales in prior periods were lower than the Company's original estimates, it recorded a decrease in its reserve for returns in each of the first quarter of 2007 and the first quarter of 2006. During the first quarter of 2007, the Company decreased its reserve for returns by approximately \$8,000 and increased its net sales from branded pharmaceuticals, excluding the adjustment to sales classified as discontinued operations, by the same amount. The effect of the change in estimate on first quarter 2007 operating income was an increase of approximately \$5,000. During the first quarter of 2006, the Company decreased its reserve for returns by approximately \$8,000 and increased its net sales from branded pharmaceuticals, excluding the adjustment to sales

classified as discontinued operations, by the same amount. The effect of the change in estimate on first quarter 2006 operating income was an increase of approximately \$6,000.

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****16. Discontinued Operations**

On March 30, 2004, the Company's Board of Directors approved management's decision to market for divestiture some of the Company's women's health products. On November 22, 2004, the Company sold all of its rights in Prefest® for approximately \$15,000. On December 23, 2004, the Company sold all of its rights in Nordette® for approximately \$12,000.

The Prefest® and Nordette® product rights had identifiable cash flows that were largely independent of the cash flows of other groups of assets and liabilities and are classified as discontinued operations in the accompanying financial statements. Prefest® and Nordette® were formerly included in the Company's branded pharmaceuticals segment.

Summarized financial information for the discontinued operations is as follows:

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2007	
	2007	2006	2007	2006
Total revenues	\$ (114)	\$ 157	\$ (336)	\$ (93)
Operating income (loss)	(115)	157	(335)	(90)
Net income (loss)	\$ (74)	\$ 100	\$ (215)	\$ (58)

Discontinued operations during 2007 and 2006 are primarily due to changes in estimated reserves for returns and rebates.

17. Guarantor Financial Statements

On April 23, 2002, the Company established a \$400,000 five-year Senior Secured Revolving Credit Facility which was scheduled to mature in April 2007 (the 2002 Credit Facility). On April 19, 2007, this facility was terminated and replaced with a new \$475,000 five-year Senior Secured Revolving Credit Facility which matures in April 2012 (the 2007 Credit Facility).

Each of the Company's subsidiaries, except Monarch Pharmaceuticals Ireland Limited (the Guarantor Subsidiaries), guaranteed on a full, unconditional and joint and several basis the Company's performance under the \$400,000 aggregate principal amount of the Notes and under the 2002 Credit Facility on a joint and several basis.

Four of the Guarantor Subsidiaries, King Pharmaceuticals Research and Development, Inc., Monarch Pharmaceuticals, Inc., Meridian Medical Technologies, Inc., and Parkedale Pharmaceuticals, Inc., have guaranteed on a full, unconditional and joint and several basis the Company's performance under the 2007 Credit Facility.

There are no restrictions under the Company's current financing arrangements, and there were no restrictions under the 2002 Credit Facility, on the ability of the Guarantor Subsidiaries to distribute funds to the Company in the form of cash dividends, loans or advances. The following combined financial data provides information regarding the financial position, results of operations and cash flows of the Guarantor Subsidiaries for the \$400,000 aggregate

principal amount of the Notes and the 2002 Credit Facility (condensed consolidating financial data). Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that such information would not be material to the holders of the debt.

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING BALANCE SHEETS**

King	June 30, 2007			King Consolidated	King	December 31, 2006		
	Guarantor Subsidiaries	Guarantor Subsidiaries (Unaudited)	Eliminating Entries			Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminating Entries
(In thousands)								
ASSETS								
\$ 43,093	\$ 6,391	\$ 5,221	\$	\$ 54,705	\$ 101,210	\$ 8,749	\$ 3,818	\$
867,998				867,998	890,185			
1,766	258,461	830		261,057	3,056	258,825	2,058	
158,239	26,732	411		185,382	176,389	25,933	255	
13,007	50,014			63,021	30,051	51,940		
1,250	947	(9)		2,188				
50,927	14,605	(23)	(3,040)	62,469	99,678	6,891	26	
	15,602			15,602		14,409		
1,136,280	372,752	6,430	(3,040)	1,512,422	1,300,569	366,747	6,157	
111,913	130,024			241,937	109,572	134,810		
	999,857	2,846		1,002,703		787,347	2,966	
	129,046			129,046		121,152		
11,237				11,237	11,578			
6,782	298,213	907		305,902	(2,111)	272,868	797	
43,598	58,671			102,269	40,142	53,205		
	72,829			72,829		123,732		
1,620,165			(1,620,165)		2,615,029			(2,615,029)
\$ 2,929,975	\$ 2,061,392	\$ 10,183	\$ (1,623,205)	\$ 3,378,345	\$ 4,074,779	\$ 1,859,861	\$ 9,920	\$ (2,615,029)

LIABILITIES AND SHAREHOLDERS EQUITY

\$ 44,309	\$ 28,575	\$ 344	\$ (3,040)	\$ 70,188	\$ 51,671	\$ 25,063	\$ 424	\$
36,086	314,835	4		350,925	134,089	376,051	(3)	
					28,045	2,456		
80,395	343,410	348	(3,040)	421,113	213,805	403,570	421	
400,000				400,000	400,000			
60,256	7,965			68,221	16,243	6,886		
(99,687)	99,147	540			1,156,125	(1,168,516)	12,391	
440,964	450,522	888	(3,040)	889,334	1,786,173	(758,060)	12,812	
2,489,011	1,610,870	9,295	(1,620,165)	2,489,011	2,288,606	2,617,921	(2,892)	(2,615)
\$ 2,929,975	\$ 2,061,392	\$ 10,183	\$ (1,623,205)	\$ 3,378,345	\$ 4,074,779	\$ 1,859,861	\$ 9,920	\$ (2,615)

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS**

	Three Months Ended June 30, 2007				Three Months Ended June 30, 2006				
	King	Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminating Entries	King Consolidated (Unaudited) (In thousands)	King	Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminating Entries
Revenue	\$ 130,933	\$ 520,847 20,396	\$ 78	\$ (129,528)	\$ 522,330 20,396	\$ 112,993	\$ 478,659 21,085	\$ (146)	\$ (112,946)
Costs	130,933	541,243	78	(129,528)	542,726	112,993	499,744	(146)	(112,946)
Depreciation and amortization	46,109	208,905	44	(129,528)	125,530	46,088	173,820	86	(112,946)
Interest expense	68,203	104,781	224		173,208	53,789	100,730	(361)	
Other income and expense	1,234	39,221			40,455	2,048	32,582		
Provision for doubtful accounts	4,883	35,469 74,810	60		40,412 74,810	6,759	31,728 279	60	
Other charges							(8)		
Operating costs and expenses	120,429	463,186	328	(129,528)	454,415	108,684	339,131	(215)	(112,946)
Income (expense) before income taxes	10,504	78,057	(250)		88,311	4,309	160,613	69	
Income tax expense	8,496 (1,849)	21 (4)			8,517 (1,853)	8,363 (2,907)	30 (140)		
Income (loss) before interest	175	38	65		278	(313) (173)	(245)	214	
Interest income	51,555			(51,555)		114,690			(114,690)
Income (loss)	(6,051)	6,112	(61)			(15,044)	15,216	(172)	

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

Income	52,326	6,167	4	(51,555)	6,942	104,616	14,861	42	(114,690)
Income from operations	62,830	84,224	(246)	(51,555)	95,253	108,925	175,474	111	(114,690)
Income from operations, net of taxes (benefit)	(1,955)	32,435	(86)		30,394	(1,978)	60,956	39	
Income from operations	64,785	51,789	(160)	(51,555)	64,859	110,903	114,518	72	(114,690)
Income from operations:									
Income from operations, net of taxes (benefit)		(115)			(115)		157		
		(41)			(41)		57		
Income from operations, net of taxes (benefit)		(74)			(74)		100		
Income (loss)	\$ 64,785	\$ 51,715	\$ (160)	\$ (51,555)	\$ 64,785	\$ 110,903	\$ 114,618	\$ 72	\$ (114,690)

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS**

King	Six Months Ended June 30, 2007				King	Six Months Ended June 30, 2006			
	Guarantor Subsidiaries	Guarantor Subsidiaries	Non Eliminations	King Consolidated (Unaudited) (In thousands)		Guarantor Subsidiaries	Guarantor Subsidiaries	Non Eliminations	King Consolidated (Unaudited) (In thousands)
\$ 258,695	\$ 1,016,108	\$ 127	\$ (256,894)	\$ 1,018,036	\$ 210,825	\$ 941,327	\$ 1,411	\$ (210,4	
	40,720			40,720		40,721			
258,695	1,056,828	127	(256,894)	1,058,756	210,825	982,048	1,411	(210,4	
93,295	400,347	236	(256,894)	236,984	83,443	325,602	811	(210,4	
139,070	202,355	95		341,520	102,875	222,391	(765)		
2,022	70,704			72,726	2,921	146,591			
9,680	66,290	120		76,090	10,769	62,023	120		
	74,810			74,810		279			
460				460		(8)			
244,527	814,506	451	(256,894)	802,590	200,008	756,878	166	(210,4	

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

	14,168	242,322	(324)		256,166	10,817	225,170	1,245	
expense):									
	17,719	60	4		17,783	14,216	137		
	(3,852)	(26)			(3,878)	(5,888)	(143)		
debt						709			
	(384)	(7)	126		(265)	(230)	(779)	295	
of									
	160,499			(160,499)		165,908			(165,908)
dend									
	969,849			(969,849)					
rest									
	(10,988)	11,107	(119)			(25,693)	25,997	(304)	
e									
	1,132,843	11,134	11	(1,130,348)	13,640	149,022	25,212	(9)	(165,908)
n ons									
es	1,147,011	253,456	(313)	(1,130,348)	269,806	159,839	250,382	1,236	(165,908)
it)									
	(3,536)	92,539	(110)		88,893	(1,741)	85,219	433	
n ons									
	1,150,547	160,917	(203)	(1,130,348)	180,913	161,580	165,163	803	(165,908)
ations:									
inued									
		(335)			(335)		(90)		
t									
		(120)			(120)		(32)		
ations									
		(215)			(215)		(58)		

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

\$ 1,150,547 \$ 160,702 \$ (203) \$ (1,130,348) \$ 180,698 \$ 161,580 \$ 165,105 \$ 803 \$ (165,9

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**

	Six Months Ended June 30, 2007				Six Months Ended June 30, 2006			
	King	Guarantor Subsidiaries	Non Guarantor Subsidiaries	King Consolidated (Unaudited) (In thousands)	King	Guarantor Subsidiaries	Non Guarantor Subsidiaries	King Consolidated
Cash flows provided by operating activities	\$ (18,093)	\$ 269,952	\$ 863	\$ 252,722	\$ (43,349)	\$ 213,334	\$ 459	\$ 170,444
Cash flows from investing activities:								
Transfers (to) from restricted cash	(231)			(231)	128,874			128,874
Purchases of investments in debt securities	(869,683)			(869,683)	(766,117)			(766,117)
Proceeds from maturities and sales of investments in debt securities	891,870			891,870	482,152			482,152
Purchases of property, plant and equipment	(11,654)	(6,440)		(18,094)	(11,022)	(9,381)		(20,403)
Proceeds from sale of property and equipment		3		3				
Acquisition of Avinza®	(23)	(296,469)		(296,492)				
Loan repayment from Ligand	37,750			37,750				
Purchases of product rights		(15,058)		(15,058)		(24,085)		(24,085)

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

and intellectual property Arrow International Limited collaboration agreement		(50,000)		(50,000)		(35,000)		(35,000)
Net cash provided by (used in) investing activities	48,029	(367,964)		(319,935)	(166,113)	(68,466)		(234,579)
Cash flows from financing activities:								
Proceeds from exercise of stock options, net	9,156			9,156	6,698			6,698
Excess tax benefit from stock-based compensation	608			608	397			397
Proceeds from issuance of long-term debt					400,000			400,000
Payments on long-term debt					(338,434)			(338,434)
Debt issuance costs	(1,623)			(1,623)	(10,659)			(10,659)
Intercompany	(96,194)	95,654	540		137,523	(138,338)	815	
Net cash (used in) provided by financing activities	(88,053)	95,654	540	8,141	195,525	(138,338)	815	58,002
(Decrease) increase in cash and cash equivalents	(58,117)	(2,358)	1,403	(59,072)	(13,937)	6,530	1,274	(6,133)
Cash and cash equivalents, beginning of period	101,210	8,749	3,818	113,777	26,802	1,071	2,141	30,014
Cash and cash equivalents,	\$ 43,093	\$ 6,391	\$ 5,221	\$ 54,705	\$ 12,865	\$ 7,601	\$ 3,415	\$ 23,881

end of period

The following combined financial data provides information regarding the financial position, results of operations and cash flows of the Guarantor Subsidiaries for the 2007 Credit Facility (condensed consolidating financial data). Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that such information would not be material to the holders of the debt.

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING BALANCE SHEETS**

King	June 30, 2007			King Consolidated	King	December 31, 2006		
	Guarantor Subsidiaries	Guarantor Subsidiaries (Unaudited)	Eliminating Entries			Guarantor Subsidiaries	Guarantor Subsidiaries	Eliminating Entries
(In thousands)								
ASSETS								
\$ 43,093	\$ 6,395	\$ 5,217	\$	\$ 54,705	\$ 101,210	\$ 8,801	\$ 3,766	\$
867,998				867,998	890,185			
1,766	258,459	832		261,057	3,056	258,825	2,058	
158,239	17,845	9,298		185,382	176,389	16,942	9,246	
13,007	49,638	376		63,021	30,051	51,518	422	
1,250	747	191		2,188				
50,927	14,310	272	(3,040)	62,469	99,678	6,578	339	
	15,602			15,602		14,409		
1,136,280	362,996	16,186	(3,040)	1,512,422	1,300,569	357,073	15,831	
111,913	84,498	45,526		241,937	109,572	86,595	48,215	
	999,556	3,147		1,002,703		787,029	3,284	
	128,384	662		129,046		120,490	662	
11,237				11,237	11,578			
6,782	299,938	(818)		305,902	(2,111)	274,992	(1,327)	
43,598	58,671			102,269	40,142	53,161	44	
	72,829			72,829		123,732		
1,620,165			(1,620,165)		2,615,029			(2,615,029)
\$ 2,929,975	\$ 2,006,872	\$ 64,703	\$ (1,623,205)	\$ 3,378,345	\$ 4,074,779	\$ 1,803,072	\$ 66,709	\$ (2,615,029)

LIABILITIES AND SHAREHOLDERS EQUITY

\$	44,309	\$	26,501	\$	2,418	\$	(3,040)	\$	70,188	\$	51,671	\$	22,836	\$	2,651	\$	
	36,086		313,073		1,766				350,925		134,089		373,886		2,162		
											28,045		2,507		(51)		
	80,395		339,574		4,184		(3,040)		421,113		213,805		399,229		4,762		
	400,000								400,000		400,000						
	60,256		5,802		2,163				68,221		16,243		4,675		2,211		
	(99,687)		104,640		(4,953)						1,156,125		(725,304)		(430,821)		
	440,964		450,016		1,394		(3,040)		889,334		1,786,173		(321,400)		(423,848)		
	2,489,011		1,556,856		63,309		(1,620,165)		2,489,011		2,288,606		2,124,472		490,557		
\$	2,929,975	\$	2,006,872	\$	64,703	\$	(1,623,205)	\$	3,378,345	\$	4,074,779	\$	1,803,072	\$	66,709	\$	(2,615)

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
GUARANTOR SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

	Three Months Ended June 30, 2007				Three Months Ended June 30, 2006				
	King	Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminating Entries	King Consolidated (Unaudited) (In thousands)	King	Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminating Entries
	\$ 130,933	\$ 522,185 20,396	\$ 12,544	\$ (143,332)	\$ 522,330 20,396	\$ 112,993	\$ 480,651 21,085	\$ 13,068	\$ (128,152)
	130,933	542,581	12,544	(143,332)	542,726	112,993	501,736	13,068	(128,152)
and	46,109	211,495	11,258	(143,332)	125,530	46,088	180,183	8,929	(128,152)
s and	68,203	104,781	224		173,208	53,789	100,614	(245)	
	1,234	39,117	104		40,455	2,048	32,582		
d	4,883	33,941 74,810	1,588		40,412 74,810	6,759	30,765 279	1,023	
nts charges								(8)	
costs and	120,429	464,144	13,174	(143,332)	454,415	108,684	344,423	9,699	(128,152)
ne expense):	10,504	78,437	(630)		88,311	4,309	157,313	3,369	
	8,496 (1,849)	21 (4)			8,517 (1,853)	8,363 (2,907)	30 (140)		
of debt	175	43	60		278	(313) (173)	(225)	194	
gs of	51,555			(51,555)		114,690			(114,690)
terest)	(6,051)	3,809	2,242			(15,044)	8,862	6,182	

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

me	52,326	3,869	2,302	(51,555)	6,942	104,616	8,527	6,376	(114,690)
om									
tions	62,830	82,306	1,672	(51,555)	95,253	108,925	165,840	9,745	(114,690)
axes	(1,955)	31,866	483		30,394	(1,978)	60,956	39	
nse									
ntinuing	64,785	50,440	1,189	(51,555)	64,859	110,903	104,884	9,706	(114,690)
erations:									
rom									
erations		(115)			(115)		157		
efit)		(41)			(41)		57		
me from		(74)			(74)		100		
erations									
s)	\$ 64,785	\$ 50,366	\$ 1,189	\$ (51,555)	\$ 64,785	\$ 110,903	\$ 104,984	\$ 9,706	\$ (114,690)

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS**

King	Six Months Ended June 30, 2007				King Consolidated (Unaudited) (In thousands)	King	Six Months Ended June 30, 2006		
	Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminations	King Consolidated (Unaudited) (In thousands)			Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminations
\$ 258,695	\$ 1,018,937	\$ 25,356	\$ (284,952)	\$ 1,018,036	\$ 210,825	\$ 943,556	\$ 23,367	\$ (234,952)	
	40,720			40,720		40,721			
258,695	1,059,657	25,356	(284,952)	1,058,756	210,825	984,277	23,367	(234,952)	
93,295	407,646	20,995	(284,952)	236,984	83,443	334,779	15,819	(234,952)	
139,070	202,328	122		341,520	102,875	222,162	(536)		
2,022	70,595	109		72,726	2,921	146,591			
9,680	63,235	3,175		76,090	10,769	60,147	1,996		
	74,810			74,810		279			
es 460				460			(8)		
s and 244,527	818,614	24,401	(284,952)	802,590	200,008	763,958	17,271	(234,952)	

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

	14,168	241,043	955		256,166	10,817	220,319	6,096	
se):									
	17,719	60	4		17,783	14,216	137		
	(3,852)	(26)			(3,878)	(5,888)	(143)		
ebt						709			
	(384)	(2)	121		(265)	(230)	(768)	284	
f									
	258,003			(258,003)		165,908			(165,908)
end									
	969,849	97,504		(1,067,353)					
est									
	(10,988)	6,533	4,455			(25,693)	14,510	11,183	
	1,230,347	104,069	4,580	(1,325,356)	13,640	149,022	13,736	11,467	(165,908)
ns									
	1,244,515	345,112	5,535	(1,325,356)	269,806	159,839	234,055	17,563	(165,908)
	(3,536)	90,466	1,963		88,893	(1,741)	85,219	433	
ns									
	1,248,051	254,646	3,572	(1,325,356)	180,913	161,580	148,836	17,130	(165,908)
ions:									
ions		(335)			(335)		(90)		
)		(120)			(120)		(32)		
from		(215)			(215)		(58)		
ions									

\$ 1,248,051 \$ 254,431 \$ 3,572 \$ (1,325,356) \$ 180,698 \$ 161,580 \$ 148,778 \$ 17,130 \$ (165,000)

KING PHARMACEUTICALS, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
GUARANTOR SUBSIDIARIES**CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**

	Six Months Ended June 30, 2007				Six Months Ended June 30, 2006			
	King	Guarantor Subsidiaries	Non Guarantor Subsidiaries	King Consolidated (Unaudited) (In thousands)	King	Guarantor Subsidiaries	Non Guarantor Subsidiaries	King Consolidated
Cash flows provided by operating activities	\$ (18,093)	\$ 263,771	\$ 7,044	\$ 252,722	\$ (43,349)	\$ 199,740	\$ 14,053	\$ 170,444
Cash flows from investing activities:								
Transfers from (to) restricted cash	(231)			(231)	128,874			128,874
Purchases of investments in debt securities	(869,683)			(869,683)	(766,117)			(766,117)
Proceeds from maturities and sales of investments in debt securities	891,870			891,870	482,152			482,152
Purchases of property, plant and equipment	(11,654)	(6,017)	(423)	(18,094)	(11,022)	(6,719)	(2,662)	(20,403)
Proceeds from sale of property and equipment		3		3				
Acquisition of Avinza®	(23)	(296,469)		(296,492)				
Loan repayment from Ligand	37,750			37,750				
Purchases of product rights		(15,058)		(15,058)		(24,085)		(24,085)

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

and intellectual property Arrow International Limited collaboration agreement		(50,000)		(50,000)		(35,000)		(35,000)
Net cash provided by (used in) investing activities	48,029	(367,541)	(423)	(319,935)	(166,113)	(65,804)	(2,662)	(234,579)
Cash flows from financing activities:								
Proceeds from exercise of stock options, net	9,156			9,156	6,698			6,698
Excess tax benefit from stock-based compensation	608			608	397			397
Proceeds from issuance of long-term debt					400,000			400,000
Payments on long-term debt					(338,434)			(338,434)
Debt issuance costs	(1,623)			(1,623)	(10,659)			(10,659)
Intercompany	(96,194)	101,364	(5,170)		137,523	(127,501)	(10,022)	
Net cash (used in) provided by financing activities	(88,053)	101,364	(5,170)	8,141	195,525	(127,501)	(10,022)	58,002
(Decrease) increase in cash and cash equivalents	(58,117)	(2,406)	1,451	(59,072)	(13,937)	6,435	1,369	(6,133)
Cash and cash equivalents, beginning of period	101,210	8,801	3,766	113,777	26,802	1,172	2,040	30,014
Cash and cash equivalents,	\$ 43,093	\$ 6,395	\$ 5,217	\$ 54,705	\$ 12,865	\$ 7,607	\$ 3,409	\$ 23,881

end of period

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

The following discussion contains certain forward-looking statements that reflect management's current views of future events and operations. This discussion should be read in conjunction with the following: (a) Risk Factors set out below and in our Annual Report on Form 10-K for the year ended December 31, 2006, which are supplemented by the discussion which follows; (b) our audited consolidated financial statements and related notes which are included in our Annual Report on Form 10-K for the year ended December 31, 2006; and (c) our unaudited consolidated financial statements and related notes which are included in this report on Form 10-Q. Please see the sections entitled Risk Factors and A Warning About Forward-Looking Statements for a discussion of the uncertainties, risks and assumptions associated with these statements.

OVERVIEW

Our Business

We are a vertically integrated pharmaceutical company that develops, manufactures, markets and sells branded prescription pharmaceutical products. To capitalize on opportunities in the pharmaceutical industry, we seek to develop, in-license, acquire or obtain commercialization rights to novel branded prescription pharmaceutical products in attractive markets.

Our corporate strategy is focused on three key therapeutic areas: cardiovascular/metabolic, neuroscience, and hospital/acute care products. We believe each of our key therapeutic areas has significant market potential and our organization is aligned accordingly. We work to achieve organic growth by maximizing the potential of our currently marketed products through sales and marketing and prudent product life-cycle management. We also work to achieve organic growth through the successful development of new branded pharmaceutical products. Additionally, we seek to achieve growth through the acquisition or in-licensing of novel branded pharmaceutical products in various stages of development and technologies that have significant market potential that complement our three key therapeutic areas. We may also seek company acquisitions which add products or products in development, technologies or sales and marketing capabilities to our key therapeutic areas or that otherwise complement our operations.

Utilizing our internal resources and a disciplined business development process, we strive to be a leader and partner of choice in bringing innovative, clinically-differentiated therapies and technologies to market in our key therapeutic areas.

Recent Developments

On September 6, 2006, we entered into a definitive asset purchase agreement and related agreements with Ligand Pharmaceuticals Incorporated (Ligand) to acquire rights to Avinza[®] (morphine sulfate extended release). Avinza[®] is an extended release formulation of morphine and is indicated as a once-daily treatment for moderate to severe pain in patients who require continuous opioid therapy for an extended period of time. We completed our acquisition of Avinza[®] on February 26, 2007, acquiring all the rights to Avinza[®] in the United States, its territories and Canada. The addition of Avinza[®] complements our other opioid products that we have in development and our currently marketed product, Skelaxin[®], a muscle relaxant. For additional information, please see Note 4, Acquisitions, Dispositions, Co-Promotions and Alliances, in Part I, Financial Statements.

On January 9, 2007, we obtained an exclusive license to certain of Vascular Solutions, Inc.'s (Vascular Solutions) hemostatic products, including products which we market as Thrombi-Pad[™] and Thrombi-Gel[®] hemostats. The license also includes a product we expect to market as Thrombi-Paste[™], which is currently in development. Each of these products includes our Thrombin-JMI[®] product as a component. Vascular Solutions will manufacture for us the

products covered by the license. With the addition of these products, we have the opportunity to offer physicians a wider variety of means to administer Thrombin-JMI®. For additional information, please see Note 4, Acquisitions, Dispositions, Co-Promotions and Alliances, in Part I, Financial Statements.

During the second quarter of 2007, we completed our Phase III clinical trial program evaluating the combination of Altace® with a hydrochlorothiazide diuretic, an investigational drug product we are developing. The clinical trial program for this drug met its primary and secondary endpoints. The clinical trial data demonstrated the efficacy and tolerability benefits of Altace® 20mg, the maximum approved dose, and the benefits of 20mg of Altace® combined with a diuretic for patients who require an antihypertensive agent as well as a diuretic. Later this year, we plan to submit these data to the U.S. Food and Drug Administration (FDA) as part of a New Drug Application for an Altace® diuretic combination product.

In June 2007, the FDA approved our Thrombin-JMI® Epistaxis Kit, a new intranasal spray delivery device for Thrombin-JMI® for use to aid in stopping epistaxes (nosebleeds). The kit offers healthcare professionals in the emergency department and trauma center a convenient new option to achieve fast, active hemostasis during epistaxes. We plan to begin marketing the Thrombin-JMI® Epistaxis Kit in the United States by the fourth quarter of this year, further expanding our portfolio of Thrombin-JMI® products.

Importantly, we, together with our partner Pain Therapeutics, recently announced the completion of patient enrollment in the pivotal Phase III clinical trial for Remoxy™, our lead investigational product for moderate to severe pain. Remoxy™ sustained release formulation has the potential to reduce the improper and often intentional accelerated release of oxycodone through crushing, heating, or dissolution in alcohol that is reported with respect to other long acting opioids. Results from this trial are expected in the fourth quarter of 2007, after the last patient completes the three-month treatment period.

Also in July 2007, we entered into an asset purchase agreement with JHP Pharmaceuticals, LLC (JHP), pursuant to which JHP will acquire King's Rochester, Michigan sterile manufacturing facility, some of King's legacy products that are manufactured there, and the related contract manufacturing business. The companies also entered into a manufacturing and supply agreement pursuant to which JHP will provide certain filling and finishing manufacturing activities with respect to Thrombin-JMI®. Under the terms of the asset purchase agreement, JHP will pay us approximately \$90 million, subject to final inventory adjustments. The agreement is subject to customary regulatory approvals, including antitrust review under the Hart-Scott-Rodino Antitrust Improvements Act. We expect to close the transaction during the third quarter of 2007. The redeployment of our investments in the assets subject to this agreement should enable us to bolster our ongoing business development and research and development initiatives, which we believe are more likely to contribute to our potential for long-term growth.

RESULTS OF OPERATIONS*Three and Six Months Ended June 30, 2007 and 2006*

The following table summarizes total revenues and cost of revenues by operating segment, excluding intercompany transactions:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Total Revenues				
Branded pharmaceuticals	\$ 466,931	\$ 419,118	\$ 916,018	\$ 836,738
Meridian Medical Technologies	50,896	53,883	93,911	95,167
Royalties	20,396	21,085	40,720	40,721
Contract manufacturing	3,450	5,559	6,658	11,254
Other	1,053		1,449	
Total revenues	\$ 542,726	\$ 499,645	\$ 1,058,756	\$ 983,880
Cost of Revenues, exclusive of depreciation, amortization and impairments				
Branded pharmaceuticals	\$ 95,759	\$ 75,703	\$ 182,633	\$ 141,094
Meridian Medical Technologies	20,748	23,756	39,188	43,003
Royalties	2,627	2,556	5,070	4,926
Contract manufacturing	3,285	5,033	6,289	10,429
Other	3,111		3,804	
Total cost of revenues	\$ 125,530	\$ 107,048	\$ 236,984	\$ 199,452

The following table summarizes our gross to net sales deductions:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Gross Sales	\$ 667,423	\$ 616,569	\$ 1,302,262	\$ 1,224,429
Commercial Rebates	45,124	40,766	94,062	97,044
Medicaid Rebates	12,179	9,600	20,897	18,312
Medicare Part D Rebates	14,670	14,702	29,636	25,870
Chargebacks	22,582	22,857	46,227	52,247
Returns	6,490	8,244	5,236	7,542
Trade Discounts/Other	23,766	20,598	47,784	39,627

Edgar Filing: KING PHARMACEUTICALS INC - Form 10-Q

	542,612	499,802	1,058,420	983,787
Discontinued Operations	(114)	157	(336)	(93)
Net Sales	\$ 542,726	\$ 499,645	\$ 1,058,756	\$ 983,880

Gross sales were higher in the second quarter of 2007 compared to the second quarter of 2006 and in the first six months of 2007 compared to the first six months of 2006 primarily due to the acquisition of Avinza® on February 26, 2007 and price increases on various products.

During January 2006, the Medicare Prescription Drug Improvement and Modernization Act became effective, which provides outpatient prescription drug coverage to senior citizens and certain disabled citizens in the United States. We have contracts with organizations that administer the Medicare Part D Program which

require us to pay rebates based on contractual pricing and actual utilization under the plans. Initial enrollment in the Medicare Part D Program was open through the middle of the second quarter of 2006.

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

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

	2007	2006
Balance at January 1, net of prepaid amounts	\$ 53,765	\$ 126,240
Current provision related to sales made in current period	72,088	79,690
Current provision related to sales made in prior periods	534	(3,532)
Rebates paid	(67,255)	(115,999)
Balance at March 31, net of prepaid amounts	\$ 59,132	\$ 86,399
Current provision related to sales made in current period	72,822	69,912
Current provision related to sales made in prior periods	(849)	(4,844)
Rebates paid	(72,924)	(82,158)
Balance at June 30, net of prepaid amounts	\$ 58,181	\$ 69,309

Rebates include commercial rebates and Medicaid and Medicare rebates.

During the first quarter of 2006, we paid approximately \$129.3 million related to (i) the settlement agreements with the Office of Inspector General of the United States Department of Health and Human Services (HHS/OIG) and the Department of Veterans Affairs, to resolve the governmental investigations related to our underpayment of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002 and (ii) similar state settlement agreements. For a discussion regarding this settlement, please see Settlement of Governmental Pricing Investigation included in Note 8, Commitments and Contingencies, in Part I, Financial Statements. Of the \$129.3 million paid in the first quarter of 2006, approximately \$64.0 million reduced the rebate accrual and is reflected in Rebates paid in the table above.

In addition, during the first quarter of 2006, we delayed our regular periodic Medicaid rebate payments as a result of prior overpayments. During the second quarter of 2006, we began reducing our payments for Medicaid rebates to utilize overpayments made to the government related to Medicaid during the government pricing investigation in 2003, 2004 and 2005. During the period of the investigation, we made actual Medicaid payments in excess of estimated expense to avoid any underpayments to the government. As a result of refining the AMP and Best Price calculations in the third quarter of 2005, we discontinued the practice of making payments in excess of the amounts expensed. We expect to recover the remaining overpayments to the government and will continue to reduce cash payments in the future until this overpayment is fully recovered. For a discussion regarding this investigation, please see Note 8, Commitments and Contingencies, in Part I, Financial Statements. In the second quarter of 2006, the utilization of overpayments reduced our rebate payments by \$19.8 million. In the second quarter and first six months of 2007, the utilization of overpayments reduced our rebate payments by approximately \$1.6 million and \$3.9 million, respectively. The utilization of the overpayments has therefore reduced Rebates paid in the table above.

Accrual for Returns (in thousands):

	2007	2006
Balance at January 1	\$ 42,001	\$ 50,902
Current provision	(1,254)	(702)
Actual returns	(6,295)	(7,692)
Ending balance at March 31	\$ 34,452	\$ 42,508
Current provision	6,490	8,244
Actual returns	(4,767)	(4,410)
Ending balance at June 30	\$ 36,175	\$ 46,342

Our calculation for product returns reserves is based on historical sales and return rates over the period during which customers have a right of return. We also consider current wholesale inventory levels of our products. Because actual returns related to sales in prior periods were lower than our original estimates, we recorded a decrease in our reserve for returns in each of the first quarter of 2007 and the first quarter of 2006. During the first quarter of 2007, we decreased our reserve for returns by approximately \$8.0 million and increased our net sales from branded pharmaceuticals, excluding the adjustment to sales classified as discontinued operations, by the same amount. The effect of the change in estimate on first quarter 2007 operating income was an increase of approximately \$5.0 million. During the first quarter of 2006, we decreased our reserve for returns by approximately \$8.0 million and increased our net sales from branded pharmaceuticals, excluding the adjustment to sales classified as discontinued operations, by the same amount. The effect of the change in estimate on first quarter 2006 operating income was an increase of approximately \$6.0 million. The Accrual for Returns table above reflects these adjustments as a reduction in the current provision.

Accrual for Chargebacks (in thousands):

	2007	2006
Balance at January 1	\$ 13,939	\$ 13,153
Current provision	23,645	29,390
Actual chargebacks	(26,557)	(25,972)
Ending balance at March 31	\$ 11,027	\$ 16,571
Current provision	22,582	22,857
Actual chargebacks	(22,962)	(25,402)
Ending balance at June 30	\$ 10,647	\$ 14,026

Branded Pharmaceuticals Segment

	For the Three Months Ended June 30,		Change 2007 vs. 2006		For the Six Months Ended June 30,		Change 2007 vs. 2006	
	2007	2006	\$	%	2007	2006	\$	%
	(In thousands)				(In thousands)			
Branded Pharmaceutical revenue:								
<i>Altace</i> [®]	\$ 163,296	\$ 153,842	\$ 9,454	6.1%	\$ 319,916	\$ 312,690	\$ 7,226	2.3%
<i>Skelaxin</i> [®]	108,007	97,478	10,529	10.8	220,125	196,104	24,021	12.2
<i>Thrombin-JMI</i> [®]	65,156	61,907	3,249	5.2	129,131	120,104	9,027	7.5
<i>Avinza</i> [®]	34,850		34,850		44,249		44,249	
<i>Levoxyl</i> [®]	25,584	29,127	(3,543)	(12.2)	47,641	60,082	(12,441)	(20.7)
<i>Sonata</i> [®]	16,590	23,912	(7,322)	(30.6)	40,443	45,178	(4,735)	(10.5)
<i>Other</i>	53,448	52,852	596	1.1	114,513	102,580	11,933	11.6
Total revenue	466,931	419,118	47,813	11.4	916,018	836,738	79,280	9.5
Cost of revenues, exclusive of depreciation, amortization and impairments	95,759	75,703	20,056	26.5	182,633	141,094	41,539	29.4

Net sales from branded pharmaceutical products were higher in the second quarter of 2007 than in second quarter of 2006 and in the first six months of 2007 compared to the first six months of 2006 primarily due to the acquisition of *Avinza*[®] on February 26, 2007 and price increases on various products. Based on inventory data provided to us by our customers, we believe that wholesale inventory levels of our key products, *Altace*[®], *Skelaxin*[®], *Thrombin-JMI*[®], *Avinza*[®], *Levoxyl*[®], and *Sonata*[®] remain at normalized levels as of June 30, 2007. We estimate that wholesale and retail inventories of our products as of June 30, 2007 represent gross sales of approximately \$190.0 million to \$200.0 million.

Sales of Key Products***Altace*[®]**

Net sales of *Altace*[®] increased in the second quarter and first six months of 2007 from the second quarter and first six months of 2006 primarily due to a price increase taken in the fourth quarter of 2006, which was offset by a decrease in prescriptions. Total prescriptions for *Altace*[®] decreased approximately 5.7% and 5.2% in the second quarter of 2007 and the first six months of 2007, respectively, compared to the same periods of the prior year according to IMS America, Ltd. (IMS) monthly prescription data.

For a discussion regarding the risk of potential generic competition for *Altace*[®], please see Note 8, Commitments and Contingencies in Part I, Financial Statements.

***Skelaxin*[®]**

Net sales of Skelaxin[®] increased in the second quarter and first six months of 2007 from the second quarter and first six months of 2006 primarily due to a price increase taken in the fourth quarter of 2006 and an increase in prescriptions. During the first six months of 2007, net sales of Skelaxin[®] benefited from a favorable change in estimate during the first quarter of 2007 in the product's reserve for returns as discussed above. Total prescriptions for Skelaxin[®] increased approximately 1.5% and 0.9% in the second quarter of 2007 and the first six months of 2007, respectively, compared to the same periods of the prior year according to IMS monthly prescription data. We do not anticipate Skelaxin[®] net sales will increase at the same rate during the second half of 2007.

For a discussion regarding the risk of potential generic competition for Skelaxin[®], please see Note 8, Commitments and Contingencies, in Part I, Financial Statements.

Thrombin-JMI[®]

Net sales of Thrombin-JMI[®] increased in the second quarter and first six months of 2007 compared to the second quarter and first six months of 2006 primarily due to a price increase taken in the fourth quarter of

2006. We believe Thrombin-JMI[®] net sales in 2007 may not continue to increase at the rate experienced in the first six months of 2007 and could decrease due to the potential introduction of new competitors in the market in the second half of 2007.

Avinza[®]

On September 6, 2006, the Company entered into a definitive asset purchase agreement and related agreements with Ligand Pharmaceuticals Incorporated (Ligand) to acquire rights to Avinza[®] (morphine sulfate extended release). Avinza[®] is an extended release formulation of morphine and is indicated as a once-daily treatment for moderate to severe pain in patients who require continuous opioid therapy for an extended period of time. The Company completed its acquisition of Avinza[®] on February 26, 2007, acquiring all the rights to Avinza[®] in the United States, its territories and Canada. Net sales of Avinza[®] in the first six months of 2007 reflect sales occurring from February 26, 2007 through June 30, 2007. Total prescriptions for Avinza[®] decreased approximately 17.6% and 16.7% in the second quarter of 2007 and the first six months of 2007, respectively, compared to the same periods of the prior year according to IMS monthly prescription data.

Levoxyl[®]

Net sales of Levoxyl[®] decreased in the second quarter of 2007 and first six months of 2007 compared to the same periods in the prior year primarily due to a decrease in prescriptions in 2007 as a result of generic competition. Total prescriptions for Levoxyl[®] were approximately 13.3% and 12.3% lower in the second quarter of 2007 and the first six months of 2007, respectively, compared to the same periods of the prior year according to IMS monthly prescription data.

During the first six months of 2006, net sales of Levoxyl[®] benefited from a favorable change in estimate during the first quarter of 2006 of approximately \$7.0 million in the product's reserve for Medicaid rebates as a result of the recent government pricing investigation settlement. This benefit was substantially offset by increases in Medicaid rebate reserves for other products as a result of the settlement.

Sonata[®]

Net sales of Sonata[®] were lower in the second quarter of 2007 than in the second quarter of 2006 primarily due to a decrease in prescriptions and an increase in returns, partially offset by a price increase taken in the fourth quarter of 2006. Total prescriptions for Sonata[®] decreased approximately 17.9% and 16.0% in the second quarter of 2007 and the first six months of 2007, respectively, compared to the same periods of the prior year according to IMS monthly prescription data. The decrease in prescriptions during 2007 was primarily due to new competitors that entered the market in 2005. We have experienced periodic stock-outs in our inventory of Sonata[®] due to problems with production experienced by the third-party manufacturer of Sonata[®]. Based on our conversations with the manufacturer, and our current levels of inventory and demand for the product, we do not currently anticipate further stock-outs. However, if we do experience additional stock-outs, they would likely negatively affect net sales of Sonata[®] in future quarters. We are currently working to transfer the manufacture of Sonata[®] to another manufacturer.

Net sales of Sonata[®] were lower in the first six months of 2007 than in the first six months of 2006 primarily due to a decrease in prescriptions and an increase in returns, partially offset by a price increase taken in the fourth quarter of 2006.

For a discussion regarding the risk of potential generic competition for Sonata[®], please see Note 8, Commitments and Contingencies, in Part I, Financial Statements.

Other

Net sales of other branded pharmaceutical products were higher in the second quarter of 2007 compared to the second quarter of 2006 primarily due to price increases which were partially offset by decreases in prescriptions.

Net sales of other branded pharmaceutical products were higher in the first six months of 2007 compared to the first six months of 2006 primarily due to an increase in net sales of Bicillin® and price increases which were partially offset by decreases in prescriptions. We completed construction of facilities to produce Bicillin® at our Rochester, Michigan location and began commercial production in the fourth quarter of 2006 and replenished wholesale inventories of the product during the first quarter of 2007. Most of our other branded pharmaceutical products are not promoted through our sales force and prescriptions for many of these products are declining. As discussed above, we plan to sell several of our other branded pharmaceutical products to JHP in the second half of 2007. Considering all of these factors, we anticipate net sales of other branded pharmaceutical products will significantly decrease in the second half of 2007.

Cost of Revenues

Cost of revenues from branded pharmaceutical products increased in the second quarter and first six months of 2007 from the second quarter and first six months of 2006 primarily due to an increase in royalties associated with Skelaxin® and Avinza®.

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

Cost of revenues includes special items that resulted in a charge of \$3.8 million in the second quarter and the first six months of 2007 related to the termination of certain contracts.

Meridian Medical Technologies

	For the Three Months		Change		For the Six Months Ended		Change	
	Ended June 30, 2007	2006	2007 vs. 2006		June 30, 2007	2006	2007 vs. 2006	
	(In thousands)		\$	%	(In thousands)		\$	%
Meridian Medical Technologies revenue	\$ 50,896	\$ 53,883	\$ (2,987)	(5.5)%	\$ 93,911	\$ 95,167	\$ (1,256)	(1.3)%
Cost of revenues, exclusive of depreciation, amortization and impairments	20,748	23,756	(3,008)	(12.7)	39,188	43,003	(3,815)	(8.9)

Revenues from Meridian Medical Technologies decreased in the second quarter of 2007 compared to the second quarter of 2006 primarily due to decreases in unit sales of products to the government and decreases in unit sales of Epipen® to Dey, L.P. Revenues from Meridian Medical Technologies decreased in the first six months of 2007 compared to the first six months of 2006 primarily due to decreases in unit sales of products to the government, partially offset by an increase in revenues derived from our acquisition of the rights to market and sell Epipen® in Canada that we purchased from Allerec Laboratory LTD on March 1, 2006. Most of our Epipen® sales are based on our supply agreement with Dey, L.P., which markets, distributes and sells the product worldwide, except for Canada where it is marketed, distributed and sold by us. Revenues from Meridian Medical Technologies fluctuate based on the buying patterns of Dey, L.P. and government customers. Total prescriptions for Epipen® in the United States increased approximately 6.4% and 5.9% during the second quarter of 2007 and the first six months of 2007, respectively, compared to the same periods of the prior year according to IMS monthly prescription data.

Cost of revenues from Meridian Medical Technologies decreased in the second quarter of 2007 and in the first six months of 2007 primarily due to lower unit sales.

Royalties

	For the Three Months		Change		For the Six Months Ended		Change	
	Ended June 30,		2007 vs. 2006		June 30,		2007 vs. 2006	
	2007	2006	\$	%	2007	2006	\$	%
	(In thousands)				(In thousands)			
Royalty revenue	\$ 20,396	\$ 21,085	\$ (689)	(3.3)%	\$ 40,720	\$ 40,721	\$ (1)	(<1)%
Cost of revenues, exclusive of depreciation, amortization and impairments	2,627	2,556	71	2.8	5,070	4,926	144	2.9

Revenues from royalties are derived primarily from payments we receive based on sales of Adenoscan[®]. We are not responsible for the marketing of this product and, thus, are not able to predict whether revenue from royalties will increase or decrease in future periods. For a discussion regarding the potential risk of generic competition for Adenoscan[®], please see Note 8, Commitments and Contingencies, in Part I, Financial Statements.

Contract Manufacturing

	For the Three Months		Change		For the Six Months Ended		Change	
	Ended June 30,		2007 vs. 2006		June 30,		2007 vs. 2006	
	2007	2006	\$	%	2007	2006	\$	%
	(In thousands)				(In thousands)			
Contract manufacturing revenue	\$ 3,450	\$ 5,559	\$ (2,109)	(37.9)%	\$ 6,658	\$ 11,254	\$ (4,596)	(40.8)%
Cost of revenues, exclusive of depreciation, amortization and impairments	3,285	5,033	(1,748)	(34.7)	6,289	10,429	(4,140)	(39.7)

Revenues and cost of revenues from contract manufacturing decreased in the second quarter and first six months of 2007 compared to the second quarter and first six months of 2006 due to a lower volume of units manufactured for third parties. As discussed above, we anticipate the sale of substantially all of our contract manufacturing business to JHP in the second half of 2007. Therefore, we anticipate a significant decrease in contract manufacturing revenue in the second half of 2007.

Operating Costs and Expenses

	For the Three Months		Change		For the Six Months		Change	
	Ended June 30,		2007 vs. 2006		Ended June 30,		2007 vs. 2006	
	2007	2006	\$	%	2007	2006	\$	%
	(In thousands)				(In thousands)			
Cost of revenues, exclusive of depreciation, amortization and impairments as shown below	\$ 125,530	\$ 107,048	\$ 18,482	17.3%	\$ 236,984	\$ 199,452	\$ 37,532	18.8%
Selling, general and administrative	173,208	154,158	19,050	12.4	341,520	324,501	17,019	5.2
Research and development	40,455	34,630	5,825	16.8	72,726	149,512	(76,786)	(51.4)
Depreciation and amortization	40,412	38,547	1,865	4.8	76,090	72,912	3,178	4.4
Asset impairments	74,810	279	74,531	>100	74,810	279	74,531	>100
Restructuring charges		(8)	8	100.0	460	(8)	468	58.5
Total operating costs and expenses	\$ 454,415	\$ 334,654	\$ 119,761	35.8	\$ 802,590	\$ 746,648	\$ 55,942	7.5%

Selling, General and Administrative Expenses

	For the Three Months		Change		For the Six Months Ended		Change	
	Ended June 30,		2007 vs. 2006		June 30,		2007 vs. 2006	
	2007	2006	\$	%	2007	2006	\$	%
	(In thousands)				(In thousands)			
Selling, general and administrative, exclusive of co-promotion fees	\$ 125,684	\$ 107,126	\$ 18,558	17.3%	\$ 248,038	\$ 212,180	\$ 35,858	16.9%
Co-promotion fees	47,524	47,032	492	1.0	93,482	112,321	(18,839)	(16.8)
Total selling, general and administrative	\$ 173,208	\$ 154,158	\$ 19,050	12.4%	\$ 341,520	\$ 324,501	\$ 17,019	5.2%

As a percentage of total revenues, total selling, general, and administrative expenses were 31.9% and 30.9% in the second quarter of 2007 and the second quarter of 2006, respectively. As a percent of total revenues, total selling, general, and administrative expenses were 32.3% and 33.0% the first six months of 2007 and the first six months of 2006, respectively.

Total selling, general and administrative expenses increased in the second quarter of 2007 compared to the second quarter of 2006 primarily due to an increase in operating expenses associated with sales and marketing. The increases in sales and marketing expenses are driven by an increase in the size of our sales force and marketing costs primarily associated with Altace® and Avinza®.

Total selling, general and administrative expenses increased in the first six months of 2007 compared to the first six months of 2006 primarily due to an increase in operating expenses associated with sales and marketing for the reasons discussed above, partially offset by a decrease in co-promotion fees we pay to Wyeth under our co-promotion agreement. The co-promotion fee decreased due to a lower co-promotion fee average rate during 2007 as a result of the Amended Co-Promotion Agreement. For additional discussion regarding the Amended Co-Promotion Agreement, please see [General](#) within the [Liquidity and Capital Resources](#) section below. For a discussion regarding net sales of Altace®, please see [Altace®](#) within the [Sales of Key Products](#) section above.

Selling, general and administrative expense includes special income items of \$1.6 million and \$0.5 million in the second quarter of 2007 and the first six months of 2007, respectively, and charges of \$1.5 million and \$4.5 million in the second quarter of 2006 and the first six months of 2006, respectively, primarily due to professional fees related to the now-completed investigation of our company by the HHS/OIG and the partially completed investigation by the SEC and private plaintiff securities litigation. During the second quarter of 2007, we recorded an anticipated insurance recovery of legal fees in the amount of \$3.4 million related to the securities litigation. In July of 2007, we received payment for the recovery of these legal fees. For additional information, please see Note 8, [Commitments and Contingencies](#), in Part I, [Financial Statements](#).

Research and Development Expense

	For the Three Months		Change		For the Six Months Ended		Change	
	Ended June 30, 2007	2006	2007 vs. 2006		June 30, 2007	2006	2007 vs. 2006	
	(In thousands)		\$	%	(In thousands)		\$	%
Research and development	\$ 37,355	\$ 34,630	\$ 2,725	7.9%	\$ 69,626	\$ 64,512	\$ 5,114	7.9%
Research and development in process upon acquisition	3,100		3,100		3,100	85,000	(81,900)	(96.4)
Total research and development	\$ 40,455	\$ 34,630	\$ 5,825	16.8%	\$ 72,726	\$ 149,512	\$ (76,786)	(51.4%)

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

our portfolio. Our business model continues to focus on adding to our research and development pipeline through the acquisition of novel branded pharmaceutical products and technologies in later stages of development.

Research and development in-process upon acquisition represents the actual cost of acquiring rights to novel branded pharmaceutical projects in development from third parties, which costs we expense at the time of acquisition. We classify these costs as special items. In the first six months of 2007, special items included a charge equaling \$3.1 million for a payment to Mutual Pharmaceutical Company (Mutual) to jointly research and develop one or more improved formulations of metaxalone. During the first six months of 2006, special items included a charge equaling \$85.0 million for our acquisition of in-process research and development associated with our collaboration with Arrow to commercialize one or more novel formulations of ramipril, the active ingredient in our Altace® product.

Under the agreement with Mutual, we seek Mutual's expertise in developing improved formulations of metaxalone, including certain improved formulations Mutual has developed prior to execution of this agreement and access to the Mutual's and United Research Laboratories' rights in intellectual property pertaining to such formulations. The success of this project is dependent on additional development activities and FDA approval. The estimated cost to complete the project at the execution of the agreement was approximately \$5.0 million. In addition, we could be required to make additional milestone payments of up to \$10.0 million.

Under a series of agreements, Arrow has granted us rights to certain current and future NDAs regarding novel formulations of ramipril and intellectual property, including patent rights and technology licenses relating to these novel formulations. Arrow will have responsibility for the manufacture and supply of new formulations of ramipril for us. However, under certain conditions, we may manufacture and supply the formulations of ramipril instead of Arrow. Arrow will earn fees for the manufacture and supply of the new formulations of ramipril. Arrow filed an NDA for a tablet formulation of ramipril in January 2006. At the time of our acquisition of this project, its success was dependent on additional development activities and FDA approval. The estimated cost to complete the project at the execution of these agreements was approximately \$3.5 million. The FDA approved the NDA for the tablet formulation of ramipril on February 27, 2007. We expect to launch the tablet formulation of ramipril during the fourth quarter of 2007 or the first quarter of 2008.

Depreciation and Amortization Expense

Depreciation and amortization expense increased in the second quarter of 2007 and the first six months of 2007 compared to the second quarter of 2006 and to the first six months of 2006 primarily due to increased amortization expense related to Avinza®. On February 26, 2007, we completed our acquisition of Avinza® and began amortizing the associated intangible assets as of that date. For additional information, please see, Note 4, Acquisitions, Dispositions, Co-Promotions and Alliances, in Part 1, Financial Statements. Depreciation and amortization expense in the second quarter of 2007 and the first six months of 2007 includes a special item consisting of a \$1.5 million and \$3.0 million charge, respectively, associated with accelerated depreciation on certain assets, including those associated with our decision to transfer the production of Levoxyl® from our St. Petersburg, Florida facility to our Bristol, Tennessee facility by the end of 2008.

Other Operating Expenses

In addition to the special items described above, we incurred other special items affecting operating costs and expenses. These other special items included the following:

Intangible asset impairment charge of \$29.3 million in the second quarter of 2007 and \$0.3 million in the second quarter of 2006. The intangible asset impairment charge in the second quarter of 2007 was primarily related to our decision to no longer pursue the development of a new formulation of Intal® utilizing

hydroflouroalkane (HFA) as a propellant.

A charge of \$45.6 million in the second quarter of 2007 related to the write-down of our Rochester, Michigan sterile manufacturing facility and certain legacy branded pharmaceutical products which we have classified as held for sale. On July 14, 2007, we entered into an asset purchase agreement with JHP Pharmaceuticals, LLC (JHP), pursuant to which JHP will acquire the Company's Rochester, Michigan sterile manufacturing facility, some of the Company's legacy products that are manufactured there, and the related contract manufacturing business. For additional information, please see Note 6, Assets Held for Sale, in Part I, Financial Statements, and Recent Developments, in Part I, Management's Discussion and Analysis of Financial Condition and Results of Operations.

As of June 30, 2007, the net intangible assets associated with Synercid[®] totaled approximately \$81.1 million. We believe that these intangible assets are not currently impaired based on estimated undiscounted cash flows associated with these assets. However, if our estimates regarding future cash flows prove to be incorrect or adversely change, we may have to reduce the estimated remaining useful life and/or write off a portion or all of these intangible assets.

In addition, certain generic companies have challenged patents on Altace[®] and Skelaxin[®]. For additional information, please see Note 8, Commitments and Contingencies, in Part I, Financial Statements. If a generic version of Altace[®] or Skelaxin[®] enters the market, we may have to write-off a portion or all of the intangible assets associated with these products.

Non-Operating Items

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
Interest income	\$ 8,517	\$ 8,393	\$ 17,783	\$ 14,353
Interest expense	(1,853)	(3,047)	(3,878)	(6,031)
(Loss) gain on early extinguishment of debt		(313)		709
Other, net	278	(204)	(265)	(714)
Total other income	6,942	4,829	13,640	8,317
Income tax expense	30,394	59,017	88,893	83,911
Discontinued operations	(74)	100	(215)	(58)

Interest Income

Interest income increased during the first six months of 2007 compared to the first six months of 2006 primarily due to an increase in interest rates and a higher average balance of cash, cash equivalents and investments in debt securities in 2007 compared to 2006.

Special items affecting other income included a loss of \$0.3 million during the second quarter of 2006 and income of \$0.7 million during the first six months of 2006 resulting from the early retirement of our 23/4% Convertible Debentures due November 15, 2021.

Income Tax Expense

During the second quarter of 2007 and the first six months of 2007, our effective income tax rate for continuing operations was 31.9% and 32.9%, respectively. During the second quarter of 2006 and the first six months of 2006, our effective income tax rate for continuing operations was 34.8% and 34.2%, respectively. These rates differ from the statutory rate of 35% primarily due to tax benefits related to tax-exempt interest income, domestic manufacturing and the effect of special items, which benefits were partially offset by state taxes. Additionally, the 2006 rate benefited from charitable contributions of inventory.

Discontinued Operations

During the first quarter of 2004, our Board of Directors approved management's decision to market for divestiture some of our women's health products, including Prefest® and Nordette®, which we sold in the fourth quarter of 2004. These product rights had identifiable cash flows that were largely independent of the cash flows of other groups of assets and liabilities and are classified as discontinued operations. Accordingly, all net sales, cost of revenues, selling, general and administrative costs, amortization and other operating costs associated with Prefest® and Nordette® are included in discontinued operations in 2007 and 2006. Discontinued operations during 2007 and 2006 are primarily related to changes in estimated reserves for returns and rebates.

Liquidity and Capital Resources

General

We believe that existing balances of cash, cash equivalents, investments in debt securities and marketable securities, cash generated from operations, our existing revolving credit facility and funds potentially available to us under our universal shelf registration are sufficient to finance our current operations and working capital requirements on both a short-term and long-term basis. However, we cannot predict the amount or timing of our need for additional funds under various circumstances, which could include a significant acquisition of a business or assets, new product development projects, expansion opportunities, or other factors that may require us to raise additional funds in the future. We cannot assure you that funds will be available to us when needed on favorable terms, or at all.

On April 23, 2002, we established a \$400.0 million five-year Senior Secured Revolving Credit Facility which was scheduled to mature in April 2007. On April 19, 2007, this facility was terminated and replaced with a new \$475.0 million five-year Senior Secured Revolving Credit Facility which matures in April 2012.

In July 2007, we entered into an asset purchase agreement with JHP pursuant to which JHP will acquire King's Rochester, Michigan sterile manufacturing facility, some of King's legacy products that are manufactured there, and the related contract manufacturing business. The companies also entered into a manufacturing and supply agreement pursuant to which JHP will provide certain fill and finish manufacturing activities with respect to Thrombin-JMI®. Under the terms of the asset purchase agreement, JHP will pay us approximately \$90 million, subject to final inventory adjustments. The agreement is subject to customary regulatory approvals, including antitrust review under the Hart-Scott-Rodino Antitrust Improvements Act. We expect to close the transaction during the third quarter of 2007.

On May 18, 2007, we entered into a Product Development Agreement with Mutual Pharmaceutical Company (Mutual) and United Research Laboratories (United) to jointly research and develop one or more improved formulations of metaxalone. Under this agreement, the Company seeks Mutual's expertise in developing improved formulations of metaxalone, including certain improved formulations Mutual developed prior to execution of this agreement and access to Mutual's and United's rights in intellectual property pertaining to such formulations. We paid \$3.1 million to Mutual for development expenses, and this was recorded as in-process research and development. We could be required to make additional milestone payments of up to \$10.0 million.

On September 6, 2006, we entered into a definitive asset purchase agreement and related agreements with Ligand Pharmaceuticals Incorporated (Ligand) to acquire rights to Avinza® (morphine sulfate extended release). Avinza® is an extended release formulation of morphine and is indicated as a once-daily treatment for moderate to severe pain in patients who require continuous opioid therapy for an extended period of time. We completed the acquisition of Avinza® on February 26, 2007, acquiring all the rights to Avinza® in the United States, its territories and Canada. Under the terms of the asset purchase agreement the purchase price was \$289.7 million, consisting of \$289.3 million

in cash consideration and \$0.3 million for the assumption of a short-term liability. Additionally, we incurred acquisition costs of \$6.7 million. Of the cash payments made to Ligand, \$15.0 million is set aside in an escrow account to fund potential liabilities that Ligand could later owe the Company.

As part of the transaction, we have agreed to pay Ligand an ongoing royalty and assume payment of Ligand's royalty obligations to third parties. The royalty we will pay to Ligand consists of a 15% royalty during the first 20 months after the closing date. Subsequent royalty payments to Ligand will be based upon calendar year net sales of Avinza® as follows:

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

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

In connection with the transaction, on October 12, 2006, we entered into a loan agreement with Ligand for the amount of \$37.8 million. The principal amount of the loan was to be used solely for the purpose of paying a specific liability related to Avinza®. The loan was subject to certain market terms, including a 9.5% interest rate and security interest in the assets that comprise Avinza® and certain of the proceeds of Ligand's sale of certain assets. On January 8, 2007, Ligand repaid the principal amount of the loan of \$37.8 million and accrued interest of \$0.9 million. Pursuant to the terms of the loan agreement with Ligand, we forgave the interest on the loan and repaid Ligand the interest at the time of closing the transaction to acquire Avinza®. Accordingly, we have not recognized interest income on the note receivable.

On January 9, 2007, we obtained an exclusive license to certain hemostatic products owned by Vascular Solutions, Inc. (Vascular Solutions), including products which we market as Thrombi-Pad™ and Thrombi-Gel®. The license also includes a product we expect to market as Thrombi-Paste™, which is currently in development. Each of these products includes our Thrombin-JMI® topical hemostatic agent as a component. Vascular Solutions will manufacture and supply the products for us. Upon execution of the agreements, we made an initial payment to Vascular Solutions of \$6.0 million, a portion of which is refundable in the event FDA approval for certain of these products is not received. During the second quarter of 2007, we made an additional milestone payment of \$1.0 million. In addition, we could make additional milestone payments of up to \$1.0 million in cash.

On June 22, 2000, we entered into a Co-Promotion Agreement with Wyeth to promote Altace® in the United States and Puerto Rico through October 29, 2008, with possible extensions as outlined in the Co-Promotion Agreement. Under the agreement, Wyeth paid an upfront fee to us of \$75.0 million. In connection with the Co-Promotion Agreement, we agreed to pay Wyeth a promotional fee based on annual net sales of Altace®. On July 5, 2006, we entered into an Amended and Restated Co-Promotion Agreement with Wyeth regarding Altace®. Effective January 1, 2007, we assumed full responsibility for selling and marketing Altace®. For all of 2006, the Wyeth sales force promoted the product with us and Wyeth shared marketing expenses. We have paid or will pay Wyeth a reduced annual fee as follows:

For 2006, 15% of Altace® net sales up to \$165.0 million, 42.5% of Altace® net sales in excess of \$165.0 million and less than or equal to \$465.0 million, and 52.5% of Altace® net sales that are in excess of \$465.0 million and less than or equal to \$585.0 million.

For 2007, 30% of Altace® net sales, with the fee not to exceed \$178.5 million.

For 2008, 22.5% of Altace® net sales, with the fee not to exceed \$134.0 million.

For 2009, 14.2% of Altace® net sales, with the fee not to exceed \$84.5 million.

For 2010, 25% of Altace® net sales, with the fee not to exceed \$5.0 million.

The annual fee is accrued quarterly based on a percentage of Altace[®] net sales at a rate equal to the expected relationship of the expected fee for the quarter to applicable expected Altace[®] net sales for the year.

Wyeth will pay us a \$20.0 million milestone fee if a specified Altace[®] net sales threshold is achieved in 2008.

On June 27, 2006, we entered into a co-exclusive agreement with Depomed, Inc. (Depomed) to commercialize Depomed's Glumetza[™] product. Glumetza[™] is a once-daily, extended-release formulation of metformin for the treatment of patients with Type II diabetes that Depomed developed utilizing its proprietary

Acuform™ drug delivery technology. Under the terms of the agreement, we assumed responsibility for promoting Glumetza™ in the United States and Puerto Rico, while Depomed has the right to co-promote the product using its own sales force at some point in the future. Depomed will pay us a fee from gross profit, as defined in the agreement, generally net sales less cost of goods sold less a royalty Depomed must pay a third party. Depomed is responsible for the manufacture and distribution of Glumetza™, while we bear all costs related to the utilization of our sales force for the product. We launched the promotion of Glumetza™ in the third quarter of 2006.

On March 1, 2006, we acquired the exclusive right to market, distribute, and sell EpiPen® throughout Canada and other specific assets from AllereX Laboratory LTD. Under the terms of the agreements, the initial purchase price was approximately \$23.9 million, plus acquisition costs of approximately \$0.7 million. As an additional component of the purchase price, we pay AllereX an earn-out equal to a percentage of future sales of EpiPen® in Canada over a fixed period of time. As these additional payments accrue, we will increase intangible assets by the amount of the accrual. The aggregate amount of these payments will not exceed \$13.2 million.

On February 12, 2006, we entered into a collaboration with Arrow to commercialize one or more novel formulations of ramipril, the active ingredient in our Altace® product. Under a series of agreements, Arrow granted us rights to certain current and future New Drug Applications (NDAs) regarding novel formulations of ramipril and intellectual property, including patent rights and technology licenses relating to these novel formulations. On February 27, 2007, the FDA approved an NDA arising from this collaboration for an Altace® tablet formulation. Arrow granted us an exclusive option to acquire their entire right, title and interest to the Ramipril Application or any future filed Amended Ramipril Application for the amount of \$5.0 million. In April 2007, we exercised this option and paid \$5.0 million to Arrow. As a result, we own the entire right, title and interest in and to the Ramipril Application. Arrow will have responsibility for the manufacture and supply of the new formulations of ramipril for us. However, under certain conditions we may manufacture and supply new formulations of ramipril.

Upon execution of the agreements, we made an initial payment to Arrow of \$35.0 million. During the fourth quarter of 2006 and the first and second quarters of 2007, we made additional payments of \$25.0 million in each of the three quarters to Arrow. We classified these payments as in-process research and development expense in 2006. Additionally, Arrow will earn fees for the manufacture and supply of the new formulations of ramipril.

On February 12, 2006, we entered into an agreement with Cobalt Pharmaceuticals, Inc. (Cobalt), an affiliate of Arrow International Limited, whereby Cobalt will have the non-exclusive right to distribute a generic version of our currently marketed Altace® product in the U.S. market, which would be supplied by us.

In December 2005, we entered into a cross-license agreement with Mutual. Under the terms of the agreement, each of the parties has granted the other a worldwide license to certain intellectual property, including patent rights and know-how, relating to metaxalone. As of January 1, 2006, we began paying royalties on net sales of products containing metaxalone to Mutual. This royalty increased in the fourth quarter of 2006 due to the achievement of a certain milestone and may continue to increase depending on the achievement of certain regulatory and commercial milestones in the future. The royalty we pay to Mutual is in addition to the royalty we pay to Elan Corporation, plc (Elan) on our current formulation of metaxalone, which we refer to as Skelaxin

During the fourth quarter of 2005, we entered into a strategic alliance with Pain Therapeutics, Inc. to develop and commercialize Remoxy™ and other opioid painkillers. Remoxy™ is an investigational drug in late-stage clinical development by Pain Therapeutics for the treatment of moderate-to-severe chronic pain. Importantly, Remoxy™ sustained release formulation has the potential to reduce the improper and often intentional accelerated release of oxycodone through crushing, heating, or dissolution in alcohol that is reported with respect to other long-acting opioids. Under the strategic alliance, we made an upfront cash payment of \$150.0 million in December 2005 and made a milestone payment of \$5.0 million in July 2006 to Pain Therapeutics. In addition, we may pay additional

milestone payments of up to \$145.0 million in cash based on the successful clinical and regulatory development of Remoxy™ and other opioid products. This

amount includes a \$15.0 million cash payment upon acceptance of a regulatory filing for Remoxy™ and an additional \$15.0 million upon its approval. We are responsible for all research and development expenses related to this alliance, which could, under the terms of the agreement, total \$100.0 million over four years. After regulatory approval and commercialization of Remoxy™ or other products developed through this alliance, we will pay a royalty of 15% of the cumulative net sales up to \$1.0 billion and 20% of the cumulative net sales over \$1.0 billion.

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

Elan was working to develop a modified release formulation of Sonata®, which we refer to as Sonata® MR, pursuant to an agreement we had with them which we refer to as the Sonata® MR Development Agreement. In early 2005, we advised Elan that we considered the Sonata® MR Development Agreement terminated for failure to satisfy the target product profile required by us. Elan disputed the termination and initiated an arbitration proceeding. During December of 2006, the arbitration panel reached a decision in favor of Elan and ordered us to pay Elan certain milestone payments and other research and development-related expenses of approximately \$49.8 million, plus interest from the date of the decision. In January 2007, we paid Elan \$50.1 million, which included interest of \$0.4 million.

Settlement of Governmental Pricing Investigation

As previously reported, during the first quarter of 2006, we paid approximately \$129.3 million, comprising (i) all amounts due under the settlement agreements resolving the governmental investigations related to our underpayment of rebates owed to Medicaid and other governmental pricing programs during the period from 1994 to 2002 (the Settlement Agreements) and (ii) all our obligations to reimburse other parties for expenses related to the settlement, including the previously disclosed legal fees of approximately \$0.8 million and the previously disclosed settlement costs of approximately \$1.0 million.

The individual purportedly acting as a relator under the False Claims Act appealed certain decisions of the District Court denying the relator's request to be compensated out of the approximately \$31 million that was paid by us to those states that do not have legislation providing for a relator's share. The purported relator asserted for the first time on appeal that we should be responsible for making such a payment to this individual. Oral argument of the appeal before the United States Court of Appeals for the Third Circuit was heard on May 8, 2007. On July 16, 2007, the Court of Appeals affirmed the District Court's decision in all respects, and denied the relator's assertions with respect to us. The relator has exercised his limited rights to appeal the Court of Appeals' decision. We believe that the claim against us is without merit and we do not expect the result of this appeal or any subsequent appeal to have a material effect on us.

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

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

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

SEC Investigation

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

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

Securities and Derivative Litigation

As previously reported, on July 31, 2006 the parties entered into a stipulation of settlement and a supplemental agreement (together, the Settlement Agreement) to resolve the federal securities litigation related to our underpayments of rebates owed to Medicaid and other governmental pricing programs and certain other matters. On January 9, 2007, the court granted final approval of the Settlement Agreement. The Settlement Agreement provides for a settlement amount of \$38.3 million, which has been fully funded by our insurance carriers on our behalf and placed into an escrow account controlled by the court. For additional information about this settlement, please see Note 8, Commitments and Contingencies, in Part I, Financial Statements.

Beginning in March 2003, four purported shareholder derivative complaints were also filed in Tennessee state court alleging a breach of fiduciary duty, among other things, by some of our current and former officers and directors, with respect to the same events at issue in the federal securities litigation described above. These cases have been consolidated. In June 2007, plaintiffs filed a motion to amend the complaint, seeking to name as defendants additional current and former officers and directors and our independent auditors and to add additional claims. Trial is scheduled to begin on September 22, 2008.

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

During the third quarter of 2006 and the second quarter of 2007, we recorded an anticipated insurance recovery of legal fees in the amount of \$6.8 million and \$3.4 million, respectively, for the class action and derivative suits described above. In November of 2006 and July of 2007, we received payment for the recovery of these legal fees.

We are currently unable to predict the outcome or to reasonably estimate the range of potential loss, if any, except as noted above, in the pending litigation. If we were not to prevail in the pending litigation, the outcome of which we cannot predict or reasonably estimate at this time, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Patent Challenges

Certain generic companies have challenged patents on Altace[®], Skelaxin[®], Sonata[®] and Adenoscan[®]. For additional information, please see Note 8, Commitments and Contingencies, in Part I, Financial Statements. If a generic version of Altace[®], Skelaxin[®], Sonata[®] or Adenoscan[®] enters the market, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Cash Flows***Operating Activities***

	For the Six Months Ended June 30,	
	2007	2006
	(In thousands)	
Net cash provided by operating activities	\$ 252,722	\$ 170,444

Our net cash from operations was higher in 2007 than in 2006 primarily due to our payment in 2006 of \$129.3 million pursuant to the Settlement Agreements described in the section entitled Settlement of Government Pricing Investigation above. Our net cash flows from operations in 2007 includes the effect of a \$50.1 million payment we made as a result of a binding arbitration proceeding with Elan in 2006.

The following table summarizes the changes in operating assets and liabilities and deferred taxes that occurred during the six months ending June 30, 2007 and 2006 and the resulting cash provided by (used in) operating activities:

	For the Six Months Ended June 30,	
	2007	2006
	(In thousands)	
Accounts receivable, net of allowance	\$ 2,972	\$ (39,011)
Inventories	18,256	21,987
Prepaid expenses and other current assets	(26,596)	(29,202)
Accounts payable	(5,735)	(14,837)
Accrued expenses and other liabilities	(69,671)	(83,988)
Income taxes payable	11,535	33,962
Deferred revenue	(2,340)	(4,546)
Other assets	(8,264)	(14,562)
Deferred taxes	(15,438)	(30,169)
Total changes in operating assets and liabilities and deferred taxes	\$ (95,281)	\$ (160,366)

Investing Activities

	For the Six Months Ended June 30,	
	2007	2006
	(In thousands)	

Net cash used in investing activities \$ (319,935) \$ (234,579)

Investing activities in 2007 include the acquisition of Avinza® for \$296.5 million, payments of \$50.0 million under our collaboration agreement with Arrow, \$6.0 million related to our acquisition of exclusive licenses from Vascular Solutions and \$5.0 million related to our acquisition of rights to the Ramipril Application from Arrow. Capital expenditures during 2007 totaled \$18.1 million, which included property, plant and equipment purchases, building improvements for facility upgrades and costs associated with improving our production capabilities, as well as costs associated with moving production of some of our pharmaceutical products to our facilities in St. Louis, Bristol and Rochester. These payments were partially offset by net proceeds from sales of investments in debt securities in the amount of \$22.2 million and the collection of the loan to Ligand in the amount of \$37.8 million.

Investing activities in 2006 primarily relate to our net proceeds from sales of investments in debt securities of \$284.0 million. We transferred \$129.3 million from restricted cash for payments associated with the Settlement Agreements noted above in cash flows from operating activities. Additionally, we made

payments totaling \$59.1 million for our collaboration agreement with Arrow and certain of its affiliates and our acquisition from AllereX Laboratory LTD of the exclusive right to market Epipen® in Canada. Capital expenditures during 2006 totaled \$20.4 million, which included property, plant and equipment purchases, building improvements for facility upgrades and costs associated with improving our production capabilities, as well as costs associated with moving production of some of our pharmaceutical products to our facilities in St. Louis, Bristol and Rochester.

We anticipate capital expenditures, including capital lease obligations, for the year ending December 31, 2007 of approximately \$53.0 million, which will be funded with cash from operations. The principal capital expenditures are anticipated to include property and equipment purchases, information technology systems and hardware, building improvements for facility upgrades, costs associated with improving our production capabilities, and costs associated with moving production of some of our pharmaceutical products to our facilities in St. Louis, Bristol and Rochester.

Financing Activities

	For the Six Months Ended June 30, 2007 2006 (In thousands)	
Net cash provided by financing activities	\$ 8,141	\$ 58,002

During 2006, we issued \$400.0 million of 11/4% Convertible Senior Notes due April 1, 2026 and repurchased almost all of our outstanding 23/4% Convertible Debentures due November 15, 2021 for \$338.4 million.

Certain Indebtedness and Other Matters

During the first quarter of 2006, we issued \$400.0 million of 11/4% Convertible Senior Notes due April 1, 2026 (Notes). The Notes are unsecured obligations and are guaranteed by each of our domestic subsidiaries on a joint and several basis. The Notes accrue interest at an initial rate of 11/4%. Beginning with the six-month interest period that commences on April 1, 2013, we will pay additional interest during any six-month interest period if the average trading price of the Notes during the five consecutive trading days ending on the second trading day immediately preceding the first day of such six-month period equals 120% or more of the principal amount of the Notes. Interest is payable on April 1 and October 1 of each year, beginning October 1, 2006.

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

During the fourth quarter of 2001, we issued \$345.0 million of 23/4% Convertible Debentures due November 15, 2021 (Debentures). On March 29, 2006, we repurchased \$165.0 million of the Debentures prior to maturity. On May 16, 2006, the interest rate on the Debentures reset to 3.5%. On June 2, 2006, we completed a tender offer, repurchasing \$175.7 million of the Debentures. On November 20, 2006, we redeemed the remaining Debentures of \$4.3 million.

In April 2002, we established a \$400.0 million five-year senior secured revolving credit facility that was scheduled to mature in April 2007. On April 19, 2007, this facility was terminated and replaced with a new \$475.0 million five-year Senior Secured Revolving Credit Facility which is scheduled to mature in April 2012 (the 2007 Credit Facility). As of June 30, 2007 up to \$474.0 million is available to us under the 2007 Credit Facility.

The 2007 Credit Facility is collateralized by a pledge of 100% of the equity of most of our domestic subsidiaries and by a pledge of 65% of the equity of our foreign subsidiaries. Our obligations under this facility are unconditionally guaranteed on a senior basis by four of our subsidiaries, King Pharmaceuticals Research and Development, Inc., Monarch Pharmaceuticals, Inc., Meridian Medical Technologies, Inc., and Parkedale Pharmaceuticals, Inc. The 2007 Credit Facility accrues interest at either, at our option, (a) the base rate, which is based on the greater of (1) the prime rate or (2) the federal funds rate plus one-half of 1%, plus an applicable spread ranging from 0.0% to 0.5% (based on a leverage ratio) or (b) the applicable LIBOR rate plus an applicable spread ranging from 0.875% to 1.50% (based on a leverage ratio). In addition, the lenders under the 2007 Credit Facility are entitled to customary facility fees based on (a) unused commitments under the facility and (b) letters of credit outstanding. The facility provides availability for the issuance of up to \$30.0 million in letters of credit. We incurred \$1.6 million of deferred financing costs in connection with the establishment of this facility, which we will amortize over five years, the life of the facility. This facility requires us to maintain a minimum net worth of no less than \$1.5 billion plus 50% of our consolidated net income for each fiscal quarter after April 19, 2007, excluding any fiscal quarter for which consolidated income is negative; an EBITDA (earnings before interest, taxes, depreciation and amortization) to interest expense ratio of no less than 3.00 to 1.00; and a funded debt to EBITDA ratio of no greater than 3.50 to 1.00. As of June 30, 2007, we were in compliance with these covenants. As of June 30, 2007, we had \$1.0 million outstanding for letters of credit.

On September 20, 2001, our universal shelf registration statement on Form S-3 was declared effective by the Securities and Exchange Commission. This universal shelf registration statement registered a total of \$1.3 billion of our securities for future offers and sales in one or more transactions and in any combination of debt and/or equity. During November 2001, we completed the sale of 17,992,000 newly issued shares of common stock for \$38.00 per share (\$36.67 per share net of commissions and expenses) resulting in net proceeds of \$659.8 million. As of June 30, 2007, there was \$616.3 million of securities remaining registered for future offers and sales under the shelf registration statement.

Impact of Inflation

We have experienced only moderate raw material and labor price increases in recent years. We have passed some price increases along to our customers.

Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are in the process of evaluating the effect of SFAS No. 157 on our financial statements and are planning to adopt this standard in the first quarter of 2008.

Effective January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*, and it seeks to reduce the variability in practice associated with measurement and recognition of tax benefits. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that an entity takes or expects to take in a tax return. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a more likely than not threshold. We recorded the cumulative effect of applying FIN 48 of \$1.5 million as a reduction to the opening balance of retained earnings as of January 1, 2007. The total net liability under FIN 48 as of January 1, 2007 was \$34.2 million. See Note 10, *Income Taxes*, in Part I, *Financial Statements*, for additional

information.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). This statement permits entities to

choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are in the process of evaluating the effect of SFAS No. 159 on our financial statements and are planning to adopt this standard in the first quarter of 2008.

Critical Accounting Policies and Estimates

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

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

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

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

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

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

Intangible assets, goodwill, and other long-lived assets. When we acquire product rights in conjunction with either business or asset acquisitions, we allocate an appropriate portion of the purchase price to intangible assets, goodwill and other long-lived assets. The purchase price is allocated to product rights and trademarks, patents, acquired research and development, if any, and other intangibles using the assistance of valuation consultants. We estimate the useful lives of the assets by factoring in the characteristics of the products such as: patent protection, competition from products prescribed for similar indications, estimated future introductions of competing products, and other issues. The factors that drive the estimate of the life of the asset are inherently uncertain. However, patents have specific legal lives over which they are amortized. Conversely, trademarks and product rights have no specific legal lives. Trademarks and product rights will continue to be an asset to us after the expiration of the patent, as their economic value is not tied exclusively to the patent. We believe that by establishing separate lives for the patent versus the trademark and product rights, we are in essence using an accelerated method of amortization for the product as a whole. This results in greater amortization in earlier years when the product is under patent protection, as we are amortizing both the patent and the trademark and product rights, and less amortization when the product faces potential generic competition, as the amortization on the patent is eliminated. Because we have no discernible evidence to show a decline in cash flows for

trademarks and product rights, or for patents, we use the straight-line method of amortization for both intangibles.

We review our property, plant and equipment and intangible assets for possible impairment whenever

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

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

The gross carrying amount and accumulated amortization of our trademarks and product rights as of June 30, 2007 are as follows:

	Cost	Accumulated Amortization (In thousands)	Net Book Value
Branded			
Altace®	\$ 281,150	\$ 93,285	\$ 187,865
Other Cardiovascular/metabolic	80,569	48,936	31,633
Cardiovascular/metabolic	361,719	142,221	219,498
Intal®	34,033	25,278	8,755
Other Hospital/acute care	170,242	53,868	116,374
Hospital/acute care	204,275	79,146	125,129
Skelaxin®	203,015	55,953	147,062
Sonata®	23,146	23,146	
Neuroscience	226,161	79,099	147,062
Other	66,643	39,086	27,557
Total Branded	858,798	339,552	519,246
<i>Meridian Medical Technologies</i>	173,844	28,434	145,410
<i>Royalties</i>	2,470	2,146	324
<i>Contract manufacturing</i>			
<i>All other</i>			
Total trademarks and product rights	\$ 1,035,112	\$ 370,132	\$ 664,980

The amounts for impairments and amortization expense and the amortization period used for the three months ended June 30, 2007 and 2006 are as follows:

	Three Months Ended June 30, 2007		Life (Years)	Three Months Ended June 30, 2006	
	Impairments (In thousands)	Amortization Expense (In thousands)		Impairments (In thousands)	Amortization Expense (In thousands)
Branded					
Altace®	\$	4,084	20	\$	\$ 3,677
Other Cardiovascular/metabolic		1,799			1,821
Cardiovascular/metabolic		5,883			5,498
Intal®	27,693	1,402	6		1,902
Other Hospital/acute care	1,566	2,833		279	3,181
Hospital/acute care	29,259	4,235		279	5,083
Skelaxin®		3,887	13.5		3,887
Other		605			795
Total Branded	29,259	14,610		279	15,263
Meridian Medical Technologies		1,984			1,903
Royalties		11			11
Contract manufacturing					
All other					
Total trademarks and product rights	\$ 29,259	\$ 16,605		\$ 279	\$ 17,177

The amounts for impairments and amortization expense and the amortization period used for the six months ended June 30, 2007 and 2006 are as follows:

	Six Months Ended June 30, 2007		Life (Years)	Six Months Ended June 30, 2006	
	Impairments (In thousands)	Amortization Expense (In thousands)		Impairments (In thousands)	Amortization Expense (In thousands)
Branded					
Altace®	\$	8,062	20	\$	\$ 7,355
Other Cardiovascular/metabolic		3,598			3,641
Cardiovascular/metabolic		11,660			10,996
Intal®	27,693	2,804	6		3,805
Other Hospital/acute care	1,566	5,666		279	6,361
Hospital/acute care	29,259	8,470		279	10,166
Skelaxin®		7,774	13.5		7,774
Other		1,211			1,590
Total Branded	29,259	29,115		279	30,526
Meridian Medical Technologies		3,950			3,397
Royalties		21			21
Contract manufacturing					
All other					
Total trademark and product rights	\$ 29,259	\$ 33,086		\$ 279	\$ 33,944

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

	Remaining Life at June 30, 2007	
	Patent	Trademark & Product Rights
Altace®	1 year 10 months	11 years 6 months
Skelaxin®		9 years 6 months
Avinza®	10 years 5 months	
Intal®		1 year 6 months

Inventories. Our inventories are valued at the lower of cost or market value. We evaluate our entire inventory for short dated or slow moving product and inventory commitments under supply agreements based on projections of future demand and market conditions. For those units in inventory that are so identified, we estimate their market value or net sales value based on current realization trends. If the projected net realizable value is less than cost, on a product basis, we make a provision to reflect the lower value of that inventory. This

methodology recognizes projected inventory losses at the time such losses are evident rather than at the time goods are actually sold. We maintain supply agreements with some of our vendors which contain minimum purchase requirements. We estimate future inventory requirements based on current facts and trends. Should our minimum purchase requirements under supply agreements or our estimated future inventory requirements exceed actual inventory quantities that we will be able to sell to our customers, we record a charge in costs of revenues.

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

determining the amount of returns, chargebacks and rebates, the actual amount of product returns and claims for chargebacks and rebates may be different from our estimates.

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

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

Revenue recognition. Revenue is recognized when title and risk of loss are transferred to customers, collection of sales is reasonably assured, and we have no further performance obligations. This is generally at the time products are received by the customer. Accruals for estimated returns, rebates and chargebacks, determined based on historical experience, reduce revenues at the time of sale and are included in accrued expenses. Medicaid and certain other governmental pricing programs involve particularly difficult interpretations of relevant statutes and regulatory guidance, which are complex and, in certain respects, ambiguous. Moreover, prevailing interpretations of these statutes and guidance can change over time. Royalty revenue is recognized based on a percentage of sales (namely, contractually agreed-upon royalty rates) reported by third parties.

A WARNING ABOUT FORWARD-LOOKING STATEMENTS

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

These forward-looking statements are identified by their use of terms and phrases, such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will and other similar terms and phrases, including assumptions. These statements are contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations section, as well as other sections of this report.

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

the potential of, including anticipated net sales and prescription trends for, our branded pharmaceutical products, particularly Altace[®], Skelaxin[®], Avinza[®], Thrombin-JMI[®], Levoxyl[®] and Sonata[®];

expectations regarding the enforceability and effectiveness of product-related patents, including in particular patents related to Altace[®], Skelaxin[®], Sonata[®] and Adenoscan[®];

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

the adequacy of our liquidity and capital resources;

anticipated capital expenditures;

the development, approval and successful commercialization of Remoxy[™], an investigational drug for the treatment of moderate-to-severe chronic pain; bremelanotide, an investigational new drug for the treatment of erectile dysfunction and female sexual dysfunction; an Altace[®] diuretic combination product for patients who require an antihypertensive as well as a diuretic; and product life-cycle development projects;

the successful execution of our growth strategies;

anticipated developments and expansions of our business;

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

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

the development of product line extensions;

the expected timing of the initial marketing of a ramipril tablet formulation and other products;

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

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

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

expectations regarding the outcome of various pending legal proceedings including the Altace® and Skelaxin® patent challenges, the SEC investigation, other possible governmental investigations, securities litigation, and other legal proceedings described in this report; and

the completion of the pending sale of our Rochester, Michigan sterile manufacturing facility, and substantially all of our contract manufacturing business;

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

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from those contemplated by our forward-looking statements. These known and unknown risks, uncertainties and other factors are described in detail below in Part II, Item 1A, *Risk Factors* and in the *Risk Factors* section, found in Part I, Item 1A of our 2006 Form 10-K, which we incorporate by reference.

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

Certain of our financial instruments are subject to market risks, including interest rate risk. Our financial instruments are not currently subject to foreign currency risk or commodity price risk. We have no financial instruments held for trading purposes.

As of June 30, 2007, there were no significant changes in our qualitative or quantitative market risk since the end of our fiscal year ended December 31, 2006.

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

The fair market value of long-term fixed interest rate debt is subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will decrease as interest rates rise and increase as interest rates fall. In addition, the fair value of our convertible debentures is affected by our stock price.

Item 4. *Controls and Procedures*

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

During our most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

The information required by this Item is incorporated by reference to Note 8 to the condensed consolidated financial statements included elsewhere in this report.

Item 1A. Risk Factors

We have disclosed a number of material risks under Item 1A of our annual report on Form 10-K for the year ended December 31, 2006 which we filed with the Securities and Exchange Commission on March 1, 2007. The following risk factor has changed materially since we filed that report.

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

Many of our product lines, including Altace[®], Skelaxin[®], Sonata[®], Intal[®], Tilade[®], Synercid[®] and Cortisporin[®], are currently manufactured in part or entirely by third parties. Upon completion of the pending sale of our Rochester, Michigan sterile manufacturing facility, a third party will provide certain filling and finishing manufacturing activities in connection with our product Thrombin-JMI[®].

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

We have experienced periodic stock-outs in our inventory of Sonata[®] due to problems with production experienced by the third-party manufacturer of Sonata[®]. Based on our conversations with the manufacturer, and our current levels of inventory and demand for the product, we do not currently anticipate further stock-outs. However, if we do experience additional stock-outs, they would likely negatively affect net sales of Sonata[®] in future quarters. We are currently working to transfer the manufacture of Sonata[®] to another manufacturer.

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

At the annual meeting of shareholders on May 16, 2007, shareholders voted on the following proposals, with the results indicated below.

1. *Election of Directors.* Shareholders elected three Class III directors to serve until the 2010 annual meeting of shareholders or until their successors have been duly elected and qualified, as follows (there were no abstentions or broker non-votes in connection with this matter):

	For	Withhold Authority
Philip A. Incarnati	211,492,619	5,704,294
Gregory D. Jordan	142,066,281	75,130,631
Brian A. Markison	208,884,777	8,312,136

Directors continuing in office following the annual meeting of shareholders were as follows:

Class I (terms to expire in 2008)

R. Charles Moyer

D. Greg Rooker

Ted G. Wood

Class II (terms to expire in 2009)

Earnest W. Deavenport, Jr.

Elizabeth M. Greetham

2. *Approval of Third Amended and Restated Charter.* Shareholders approved a Third Amended and Restated Charter providing for annual election of directors beginning, for each class of directors, at the expiration of the class's current term, and incorporating amendments to the Second Amended and Restated Charter previously approved by shareholders.

For	Against	Abstain
215,178,882	550,060	1,467,970

3. *Ratification of Independent Registered Public Accounting Firm.* Shareholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007.

For	Against	Abstain
215,021,866	932,609	1,242,437

Item 6. Exhibits

Number	Exhibit Title
3.1	Third Amended and Restated Charter of King Pharmaceuticals, Inc.
10.1(1)	Form Of Retention Grant Agreement.
10.2(1)	Form Of Long-Term Performance Unit Award Agreement.
10.3(1)	Form Of Long-Term Performance Unit Award Agreement.
10.4(1)	Form Of Restricted Stock Unit Agreement.
10.5(1)	Director Compensation Policy.
10.6	Credit Agreement dated as of April 19, 2007 among King Pharmaceuticals, Inc.; the Lenders (as defined therein); Credit Suisse, Cayman Islands Branch, as Administrative Agent, Collateral Agent and Swingline Lender; Bank of America, N.A. and UBS Securities LLC, as Cosyndication Agents; Citigroup Global Markets Inc., Wachovia Bank, National Association and The Royal Bank of Scotland plc, as Codocumentation Agents; U.S. Bank National Association as Managing Agent; and the Issuing Banks (as defined therein).
31.1	Certification by Chief Executive Officer Pursuant to Rule 13A-14(a) or 15D-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer Pursuant to Rule 13A-14(a) or 15D-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to King's Current Report on Form 8-K filed May 21, 2007.

SIGNATURES

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

KING PHARMACEUTICALS, INC

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

Date: August 7, 2007

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

Date: August 7, 2007