WATSON PHARMACEUTICALS INC
Form 10-Q
July 31, 2009

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009

or

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

For the transition period from _____ to _____

Commission file number 001-13305

WATSON PHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

Nevada	**95-3872914**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

311 Bonnie Circle
Corona, CA 92880-2882
(Address of principal executive offices, including zip code)

(951) 493-5300
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

The number of shares outstanding of the Registrant s only class of common stock as of July 27, 2009 was approximately 105,729,000

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited; in millions)

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 637.5	$ 507.6
Marketable securities	13.4	13.2
Accounts receivable, net	356.6	305.0
Inventories, net	499.3	473.1
Prepaid expenses and other current assets	60.7	48.5
Deferred tax assets	121.0	111.0
Total current assets	1,688.5	1,458.4
Property and equipment, net	635.4	658.5
Investments and other assets	86.0	80.6
Deferred tax assets	40.7	52.3
Product rights and other intangibles, net	531.7	560.0
Goodwill	868.1	868.1
Total assets	$ 3,850.4	$ 3,677.9
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 427.1	$ 381.3
Income taxes payable		15.5
Short-term debt and current portion of long-term debt	726.4	53.2
Deferred revenue	22.5	16.1
Deferred tax liabilities	14.6	15.9
Total current liabilities	1,190.6	482.0
Long-term debt	150.0	824.7
Deferred revenue	37.2	30.1
Other long-term liabilities	5.2	4.9
Other taxes payable	58.1	53.3
Deferred tax liabilities	177.2	174.3
Total liabilities	1,618.3	1,569.3
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	0.4	0.4

Additional paid-in capital	1,016.0	995.9
Retained earnings	1,520.2	1,418.1
Accumulated other comprehensive income (loss)	0.3	(3.2)
Treasury stock, at cost	(304.8)	(302.6)
Total stockholders equity	2,232.1	2,108.6
Total liabilities and stockholders equity	$ 3,850.4	$ 3,677.9

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in millions, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net revenues	$ 677.8	$ 622.7	$ 1,345.2	$ 1,249.6
Operating expenses:				
Cost of sales	393.1	359.9	781.8	740.0
Research and development	42.6	39.2	84.9	77.2
Selling and marketing	66.2	57.5	131.9	113.6
General and administrative	62.1	46.9	131.0	97.4
Amortization	22.1	20.2	43.9	40.4
Loss (gain) on asset sales	0.2		(1.3)	
Total operating expenses	586.3	523.7	1,172.2	1,068.6
Operating income	91.5	99.0	173.0	181.0
Non-operating (expense) income:				
Loss on early extinguishment of debt				(1.1)
Interest income	1.3	1.7	3.3	4.0
Interest expense	(4.6)	(6.9)	(9.3)	(13.7)
Other income	2.4	2.0	3.6	7.4
Total other expense, net	(0.9)	(3.2)	(2.4)	(3.4)
Income before income taxes	90.6	95.8	170.6	177.6
Provision for income taxes	37.6	35.5	68.5	66.7
Net income	$ 53.0	$ 60.3	$ 102.1	$ 110.9
Earnings per share:				
Basic	$ 0.51	$ 0.59	$ 0.99	$ 1.08
Diluted	$ 0.46	$ 0.53	$ 0.89	$ 0.98
Weighted average shares outstanding:				
Basic	103.4	102.7	103.2	102.7
Diluted	118.8	117.7	118.5	117.5

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in millions)

	Six Months Ended June 30,	
	2009	**2008**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 102.1	$ 110.9
Reconciliation to net cash provided by operating activities:		
Depreciation	47.3	44.1
Amortization	43.9	40.4
Deferred income tax provision	2.3	17.4
Provision for inventory reserve	25.2	22.2
Restricted stock and stock option compensation	9.6	9.3
Earnings on equity method investments	(4.7)	(5.8)
Loss (gain) on securities	1.1	(1.4)
Loss on early extinguishment of debt		1.1
(Gain) loss on asset sales	(1.3)	0.3
Other	0.6	(1.4)
Changes in assets and liabilities:		
Accounts receivable, net	(51.6)	(30.1)
Inventories	(51.4)	(22.3)
Prepaid expenses and other current assets	(12.2)	7.7
Accounts payable and accrued expenses	45.8	(18.9)
Deferred revenue	13.5	(13.0)
Income taxes payable	(11.0)	5.1
Other assets	2.0	0.6
Total adjustments	59.1	55.3
Net cash provided by operating activities	161.2	166.2
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(26.0)	(28.9)
Acquisition of product rights	(15.5)	(0.6)
Proceeds from sale of fixed assets	3.0	
Proceeds from sale of marketable securities	3.9	3.8
Additions to marketable securities	(3.0)	(3.7)
Net cash used in investing activities	(37.6)	(29.4)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on debt and other long-term liabilities	(1.6)	(95.0)
Proceeds from issuance of short-term debt and other long-term liabilities		17.0

Repurchase of common stock	(2.2)	(0.1)
Proceeds from stock plans	10.1	2.2
Net cash provided by (used in) financing activities	6.3	(75.9)
Net increase in cash and cash equivalents	129.9	60.9
Cash and cash equivalents at beginning of period	507.6	204.6
Cash and cash equivalents at end of period	$ 637.5	$ 265.5

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 GENERAL

Watson Pharmaceuticals, Inc. (Watson or the Company) is primarily engaged in the development, manufacturing, marketing, sale and distribution of brand and off-patent (generic) pharmaceutical products. Watson was incorporated in 1985 and began operations as a manufacturer and marketer of off-patent pharmaceuticals. Through internal product development and synergistic acquisitions of products and businesses, the Company has grown into a diversified specialty pharmaceutical company. Watson operates manufacturing, distribution, research and development (R&D) and administrative facilities predominantly in the United States of America (U.S.) and India with our key commercial market being the U.S.

The accompanying condensed consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2008. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted from the accompanying condensed consolidated financial statements. The year end condensed consolidated balance sheet was derived from the audited financial statements. The accompanying interim financial statements are unaudited, but reflect all adjustments which are, in the opinion of management, necessary to present fairly Watson s consolidated financial position, results of operations and cash flows for the periods presented. Unless otherwise noted, all such adjustments are of a normal, recurring nature. The Company s results of operations and cash flows for the interim periods are not necessarily indicative of the results of operations and cash flows that it may achieve in future periods.

Merger Agreement with Arrow Group

On June 17, 2009, the Company announced a definitive agreement (the Acquisition Agreement) to acquire privately held Arrow Group for cash, stock and certain contingent consideration (the Arrow Acquisition). The Arrow Acquisition will result in a global pharmaceutical company with over $3 billion in revenue, commercial operations in over 20 countries, and a robust product portfolio and pipeline. The Company expects the transaction to close in the second half of 2009. Under the terms of the Agreement, the Company will acquire all the outstanding shares of common stock of the Arrow Group for the following consideration:

A cash payment of U.S. $1.05 billion at closing of the share purchase (the Closing);

Approximately 16.9 million restricted shares of Common Stock of Watson issued at the Closing;

$200.0 million face amount of newly-designated non-voting Series A Preferred Stock of Watson issued at the Closing; and

Certain contingent payments made after the Closing based on the after-tax gross profits on sales of Atorvastatin in the United States as described in the Acquisition Agreement.

The Company intends to fund the cash portion of the consideration by using available cash and additional borrowings. The Company is evaluating options for longer-term debt financing.

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Comprehensive Income

Comprehensive income includes all changes in equity during a period except those that resulted from investments by or distributions to the Company s stockholders. Other comprehensive income refers to revenues, expenses, gains and losses that, under generally accepted accounting principles, are included in comprehensive income, but excluded from net income. The components of comprehensive income, including attributable income taxes, consisted of the following (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income	$ 53.0	$ 60.3	$ 102.1	$ 110.9
Other comprehensive income (loss):				
Translation gains (losses)	3.3	(1.3)	2.0	(0.9)
Unrealized gain (loss) on securities, net of tax	0.3	(0.1)	0.1	(0.2)
Reclassification for losses included in net income, net of tax			1.4	
Unrealized gain (loss) on cash flow hedge, net of tax		1.1		(0.3)
Total other comprehensive income (loss)	3.6	(0.3)	3.5	(1.4)
Total comprehensive income	$ 56.6	$ 60.0	$ 105.6	$ 109.5

Preferred and Common Stock

As of June 30, 2009 and December 31, 2008 there were 2.5 million shares of no par value per share preferred stock authorized, with none issued. As of June 30, 2009 and December 31, 2008, there were 500.0 million shares of $0.0033 par value per share common stock authorized, with 115.2 million and 114.1 million shares issued and 105.6 million and 104.6 million outstanding, respectively. Of the issued shares, 9.6 million and 9.5 million shares were held as treasury shares as of June 30, 2009 and December 31, 2008, respectively.

Provisions for Sales Returns and Allowances

As customary in the pharmaceutical industry, the Company s gross product sales are subject to a variety of deductions in arriving at reported net product sales. When the Company recognizes revenue from the sale of its products, an estimate of sales returns and allowances (SRA) is recorded which reduces product sales. Accounts receivable and/or accrued liabilities are also reduced and/or increased by the SRA amount. These adjustments include estimates for chargebacks, rebates, cash discounts and returns and other allowances. These provisions are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and current contract sales terms with direct and indirect customers. The estimation process used to determine our SRA provision has been applied on a consistent basis and no material adjustments have been necessary to increase or decrease our reserves for SRA as a result of a significant change in underlying estimates. The Company uses a variety of methods to assess the adequacy of our SRA reserves to ensure that our condensed consolidated financial statements are fairly stated. This includes periodic reviews of customer inventory data, customer contract programs and product pricing trends to analyze and validate the SRA reserves.

The provision for chargebacks is our most significant sales allowance. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to the Company by our wholesale customer for a particular product and the negotiated contract price that the wholesaler s customer pays for that product. The Company s chargeback provision and related reserve vary with changes in product mix, changes in customer pricing and changes to estimated wholesaler inventories. The provision for chargebacks also takes into account an estimate of the expected wholesaler sell-through levels to indirect customers at contract prices. The Company

validates the chargeback accrual quarterly through a review of the inventory reports

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obtained from our largest wholesale customers. This customer inventory information is used to verify the estimated liability for future chargeback claims based on historical chargeback and contract rates. These large wholesalers represent 85% 90% of the Company s chargeback payments. The Company continually monitors current pricing trends and wholesaler inventory levels to ensure the liability for future chargebacks is fairly stated.

Net revenues and accounts receivable balances in the Company s condensed consolidated financial statements are presented net of SRA estimates. Certain SRA balances are included in accounts payable and accrued liabilities. Accounts receivable are presented net of SRA balances of $305.4 million and $285.7 million at June 30, 2009 and December 31, 2008, respectively. Accounts payable and accrued liabilities include $45.0 million and $42.4 million at June 30, 2009 and December 31, 2008, respectively, for certain rebates and other amounts due to indirect customers.

The following table summarizes the activity in the Company s major categories of SRA (in millions):

	Chargebacks	Rebates	Returns and Other Allowances	Cash Discounts	Total
Balance at December 31, 2007	$ 164.4	$ 154.3	$ 56.1	$ 12.9	$ 387.7
Provision related to sales in six months ended June 30, 2008	614.9	150.8	83.3	32.9	881.9
Credits and payments	(643.5)	(167.3)	(82.6)	(33.4)	(926.8)
Balance at June 30, 2008	135.8	137.8	56.8	12.4	342.8
Provision related to sales in six months ended December 31, 2008	609.1	158.3	96.5	34.3	898.2
Credits and payments	(624.3)	(170.3)	(83.8)	(34.4)	(912.8)
Balance at December 31, 2008	120.6	125.8	69.5	12.3	328.2
Provision related to sales in six months ended June 30, 2009	591.2	183.7	91.2	35.5	901.6
Credits and payments	(586.7)	(180.6)	(77.6)	(34.5)	(879.4)
Balance at June 30, 2009	$ 125.1	$ 128.9	$ 83.1	$ 13.3	$ 350.4

Earnings Per Share (EPS)

Basic EPS is computed by dividing net income by the weighted average common shares outstanding during a period. Diluted EPS is based on the treasury stock method and includes the effect from potential issuance of common stock, such as shares issuable upon conversion of the $575 million convertible contingent senior debentures (CODES), and the dilutive effect of share-based compensation arrangements outstanding during the period. Common share equivalents have been excluded where their inclusion would be anti-dilutive. In accordance with Emerging Issues Task Force (EITF) Issue No. 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings per Share, the Company is required to add approximately 14.4 million shares associated with the conversion of the CODES to the number of shares outstanding for the calculation of diluted

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EPS for all periods in which the securities were outstanding. A reconciliation of the numerators and denominators of basic and diluted EPS consisted of the following (in millions, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
EPS basic				
Net income	$ 53.0	$ 60.3	$ 102.1	$ 110.9
Basic weighted average common shares outstanding	103.4	102.7	103.2	102.7
EPS basic	$ 0.51	$ 0.59	$ 0.99	$ 1.08
EPS diluted				
Net income	$ 53.0	$ 60.3	$ 102.1	$ 110.9
Add: Interest expense on CODES, net of tax	1.9	1.9	3.9	3.9
Net income, adjusted	$ 54.9	$ 62.2	$ 106.0	$ 114.8
Basic weighted average common shares outstanding	103.4	102.7	103.2	102.7
Effect of dilutive securities:				
Conversion of CODES	14.4	14.4	14.4	14.4
Dilutive stock awards	1.0	0.6	0.9	0.5
Diluted weighted average common shares outstanding	118.8	117.7	118.5	117.5
EPS diluted	$ 0.46	$ 0.53	$ 0.89	$ 0.98

Stock awards to purchase 4.1 million and 6.7 million common shares for the three month periods ended June 30, 2009 and 2008, respectively, were outstanding but were not included in the computation of diluted earnings per share because the options were antidilutive. Stock awards to purchase 4.6 million and 8.5 million common shares for the six month periods ended June 30, 2009 and 2008, respectively, were outstanding but were not included in the computation of diluted earnings per share because the options were antidilutive.

Share-Based Compensation

The Company accounts for share-based compensation under Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R) which requires the measurement and recognition of compensation expense for all share-based compensation awards made to employees and directors based on estimated fair values.

As of June 30, 2009, the Company had $2.3 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock option grants, which will be recognized over the remaining weighted average period of 1.2 years. As of June 30, 2009, the Company had $26.2 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock grants, which will be recognized over the remaining weighted average period of 2.0 years. During the six months ended June 30, 2009, the Company issued approximately 852,000 restricted stock grants with an aggregate intrinsic value of $24.0 million. No stock option grants were issued during the six

months ended June 30, 2009.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair-Value Measurements, (SFAS 157) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair-value measurements. The Company adopted SFAS 157 effective January 1, 2008 for all financial assets and liabilities and any other assets and liabilities that are recognized or disclosed at fair value on a recurring basis (refer to NOTE 9 FAIR VALUE MEASUREMENT in the accompanying Notes to Condensed Consolidated Financial Statements in this

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Quarterly Report). For nonfinancial assets and liabilities measured at fair value on a non-recurring basis, SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2008. The adoption of SFAS 157 for nonfinancial assets and liabilities measured at fair value on a non-recurring basis on January 1, 2009 did not have a material impact on the Company s condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141R) which replaces SFAS No. 141, Business Combinations . SFAS 141R establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in a business combination at their fair value at acquisition date. SFAS 141R alters the treatment of acquisition-related costs, business combinations achieved in stages (referred to as a step acquisition), the treatment of gains from a bargain purchase, the recognition of contingencies in business combinations, the treatment of in-process research and development in a business combination as well as the treatment of recognizable deferred tax benefits. SFAS 141R is effective for business combinations closed in fiscal years beginning after December 15, 2008. The Company expects the adoption of SFAS 141R will have a significant impact on the Company s condensed consolidated financial statements upon the closing of the Arrow Acquisition. In the three months ended June 30, 2009, the Company recorded acquisition expenses in the amount of $11.9 million in accordance with SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51, (SFAS 160). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company currently has no minority interests and accordingly the adoption of SFAS 160 did not have a material impact on its condensed consolidated financial statements. However, SFAS 160 may have an impact on any acquisitions we consummate after January 1, 2009.

In April 2008, the FASB issued FASB Staff Position (FSP) No. FAS 142-3, Determination of the Useful Life of Intangible Assets, (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets, and also requires expanded disclosure related to the determination of intangible asset useful lives. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP 142-3 did not have a material impact on the Company s condensed consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, (SFAS 165). SFAS 165 establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued. SFAS 165 is effective for financial statements issued for interim or fiscal years ending after June 15, 2009. The adoption of SFAS 165 in the quarter ended June 30, 2009 did not have a material impact on the Company s condensed consolidated financial statements. The Company evaluated all events or transactions that occurred after June 30, 2009 up through July 31, 2009, the date the Company issued these financial statements. During this period, the Company did have a recognizable subsequent event related to the reclassification of $100.0 million in debt to current from noncurrent liabilities as a result of the amendment of the 2006 Credit Facility on July 1, 2009 (refer to NOTE 5 DEBT for additional information). During this period, the Company did not have any material nonrecognizable subsequent events.

In June 2008, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), (SFAS 167). SFAS 167 is a revision to FIN No. 46(R), Consolidation of Variable Interest Entities, and amends the consolidation guidance for variable interest entities under FIN No. 46(R) . SFAS 167 is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the impact of the adoption of SFAS 167 on the Company s condensed consolidated financial statements.

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NOTE 2 OTHER INCOME

Other income consisted of the following (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Earnings on equity method investments	$ 2.4	$ 1.8	$ 4.7	$ 5.8
(Loss) gain on securities			(1.1)	1.4
Other income		0.2		0.2
	$ 2.4	$ 2.0	$ 3.6	$ 7.4

NOTE 3 OPERATING SEGMENTS

Watson has three reportable operating segments: Generic, Brand and Distribution. The Generic segment includes pharmaceutical products that are therapeutically equivalent to proprietary products. The Brand segment includes the Company s lines of Specialty Products and Nephrology/Medical products. Watson has aggregated its brand product lines in a single segment because of similarities in regulatory environment, methods of distribution and types of customer. This segment includes patent-protected products and certain trademarked off-patent products that Watson sells and markets as brand pharmaceutical products. The Company sells its brand and generic products primarily to pharmaceutical wholesalers, drug distributors and chain drug stores in the U.S. The Distribution segment distributes generic pharmaceutical products and select brand pharmaceutical products manufactured by third parties to independent pharmacies, pharmacy chains, pharmacy buying groups and physicians offices in the U.S. Sales are principally generated through an in-house telemarketing staff and through internally developed ordering systems. The Distribution segment operating results exclude sales of Watson products, which are included in their respective Generic and Brand segment results.

Segment net revenues and segment contribution information for the Company s Generic, Brand and Distribution segments consisted of the following (in millions):

	Three Months Ended June 30, 2009				Three Months Ended June 30, 2008			
	Generic	Brand	Distribution	Total	Generic	Brand	Distribution	Total
Product sales	$ 393.8	$ 97.6	$ 161.3	$ 652.7	$ 344.3	$ 101.5	$ 128.0	$ 573.8
Other	7.4	17.7		25.1	32.4	16.5		48.9
Net revenues	401.2	115.3	161.3	677.8	376.7	118.0	128.0	622.7
Operating expenses:								
Cost of sales[1]	234.1	22.0	137.0	393.1	227.6	24.4	107.9	359.9
Research and development	29.9	12.7		42.6	29.1	10.1		39.2
Selling and marketing	11.4	39.1	15.7	66.2	13.8	29.6	14.1	57.5
Contribution	$ 125.8	$ 41.5	$ 8.6	175.9	$ 106.2	$ 53.9	$ 6.0	166.1
Contibution margin	31.4%	36.0%	5.3%	26.0%	28.2%	45.7%	4.7%	26.7%
General and administrative				62.1				46.9

Amortization	22.1	20.2
Loss on asset sales	0.2	
Operating income	$ 91.5	$ 99.0
Operating margin	13.5%	15.9%

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	Six Months Ended June 30, 2009				Six Months Ended June 30, 2008			
	Generic	Brand	Distribution	Total	Generic	Brand	Distribution	Total
Product sales	$ 789.0	$ 195.8	$ 315.0	$ 1,299.8	$ 686.7	$ 200.5	$ 272.9	$ 1,160.1
Other	13.9	31.5		45.4	56.7	32.8		89.5
Net revenues	802.9	227.3	315.0	1,345.2	743.4	233.3	272.9	1,249.6
Operating expenses:								
Cost of sales[1]	472.6	46.2	263.0	781.8	457.3	51.9	230.8	740.0
Research and development	60.0	24.9		84.9	51.7	25.5		77.2
Selling and marketing	24.1	76.0	31.8	131.9	27.9	57.6	28.1	113.6
Contribution	$ 246.2	$ 80.2	$ 20.2	346.6	$ 206.5	$ 98.3	$ 14.0	318.8
Contibution margin	30.7%	35.3%	6.4%	25.8%	27.8%	42.1%	5.1%	25.5%
General and administrative				131.0				97.4
Amortization				43.9				40.4
Gain on asset sales				(1.3)				
Operating income				$ 173.0				$ 181.0
Operating margin				12.9%				14.5%

(1) Excludes amortization of acquired intangibles including product rights.

NOTE 4 INVENTORIES

Inventories consist of finished goods held for sale and distribution, raw materials and work-in-process. Included in inventory at June 30, 2009 and December 31, 2008 is approximately $19.2 million and $16.4 million, respectively, of inventory that is pending approval by the U.S. Food and Drug Administration (FDA) or has not been launched due to contractual restrictions. This inventory consists primarily of generic pharmaceutical products that are capitalized only when the bioequivalence of the product is demonstrated or the product is already FDA approved and is awaiting a contractual triggering event to enter the marketplace.

Inventories are stated at the lower of cost (first-in, first-out method) or market (net realizable value) and consisted of the following (in millions):

	June 30, 2009	December 31, 2008

Inventories:		
Raw materials	$ 150.8	$ 109.1
Work-in-process	69.2	44.2
Finished goods	333.9	354.5
	553.9	507.8
Less: Inventory reserves	54.6	34.7
Inventories, net	$ 499.3	$ 473.1

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NOTE 5 DEBT

Debt consisted of the following (in millions):

	June 30, 2009	December 31, 2008
Senior Credit Facility, due 2011, bearing interest at LIBOR plus 0.75% (2006 Credit Facility)	$ 300.0	$ 300.0
CODES, face amount of $575 million, due 2023, net of unamortized discount	574.8	574.7
Other notes payable	1.6	3.2
	876.4	877.9
Less: Current portion	726.4	53.2
Total long-term debt	$ 150.0	$ 824.7

Senior Credit Facility

During the quarter ended March 31, 2009, the CODES debt was reclassified to current liabilities from long-term liabilities as it is our expectation that the Company will redeem the outstanding amount of the CODES for cash within the next 12 months. For additional information regarding the terms of the CODES, refer to NOTE 9 Long-Term Debt of our Annual Report on Form 10-K for the year ended December 31, 2008. At June 30, 2009, $100.0 million of the 2006 Credit Facility was reclassified to current liabilities from long-term liabilities as the Company entered into an amendment to the 2006 Credit Facility on July 1, 2009 which, among other things, required the repayment of $100.0 million of the $250.0 million outstanding under the term facility of the 2006 Credit Facility not later than December 16, 2009.

During the six months ended June 30, 2008, the Company made prepayments of the 2006 Credit Facility totaling $75.0 million. As a result of this pre-payment, the Company s results for the six months ended June 30, 2008 reflect a $1.1 million charge for losses on the early extinguishment of debt. As of June 30, 2009, $300.0 million is outstanding under the 2006 Credit Facility. As indicated above, the amendment to the 2006 Credit Facility requires a $100.0 million principal payment on the term facility of the 2006 Credit Facility in 2009. The remaining amount outstanding on the 2006 Credit Facility is due November 2011.

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NOTE 6 BUSINESS RESTRUCTURING CHARGES

During the first quarter of 2008, the Company announced efforts to reduce its cost structure through its Global Supply Chain Initiative, which includes the planned closure of manufacturing facilities in Carmel, New York, its distribution center in Brewster, New York and the transition of manufacturing to our other manufacturing locations within the U.S. and India. While the final closing date will depend on a number of factors, we anticipate the successful transition of product manufacturing and the completion of related facility rationalization activities will permit the closure of these facilities by the end of 2010. Activity related to our Global Supply Chain Initiative restructuring and facility rationalization activities for the six months ended June 30, 2009 consisted of the following:

(in millions)	Balance at December 31, 2008	Charged to Expense	Cash Payments	Non-cash Adjustments	Accrual Balance at June 30, 2009
Cost of sales					
Severance and retention	$ 13.7	$ 5.4	$ (1.9)	$	$ 17.2
Product transfer costs	0.7	6.0	(4.1)		2.6
Facility decommission costs	0.2	0.4	(0.2)		0.4
Accelerated depreciation		3.6		(3.6)	
	14.6	15.4	(6.2)	(3.6)	20.2
Operating expenses					
Research and development	0.7	1.8	(1.6)		0.9
Selling, general and administrative	0.8	0.6	(0.4)		1.0
	1.5	2.4	(2.0)		1.9
Total restructuring charges	$ 16.1	$ 17.8	$ (8.2)	$ (3.6)	$ 22.1

Product transfer costs consist of documentation, testing and shipping costs to transfer product to other facilities. Operating expenses include severance and retention. Retention is expensed only to the extent earned by employees. Activity related to our business restructuring and facility rationalization activities in 2009 is attributable to our Generic segment.

Through the end of June 2009, the Company has recognized total charges of $48.2 million related to our Global Supply Chain Initiative. The Company expects to incur pre-tax costs associated with our Global Supply Chain Initiative of approximately $60.0 to $70.0 million which includes accelerated depreciation expense of $25.0 to $30.0 million, severance, retention, relocation and other employee related costs of approximately $25.0 to $30.0 million and product transfer costs of approximately $8.0 to $12.0 million.

NOTE 7 INCOME TAXES

The Company s effective tax rate for the six months ended June 30, 2009 was 40.1% compared to 37.6% for the six months ended June 30, 2008. The higher effective tax rate for the six months ended June 30, 2009, as compared to the same period of the prior year, primarily reflects the impact of non-deductible transaction costs related to the Arrow Acquisition, which was partially offset by a reduction in the effective tax rate for the R&D tax credit and certain permanent differences.

The Company conducts business globally and, as a result, files federal, state and foreign tax returns. In the normal course of business the Company is subject to examination by various taxing authorities. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 2000. In 2008, the IRS began examining the Company s 2004, 2005, and 2006 tax years.

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The Company accounts for uncertain tax positions in accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company believes its reserves for income taxes represent the likely outcome. The Company adjusts these reserves, as well as the related interest, in light of changing facts and circumstances.

NOTE 8 STOCKHOLDERS EQUITY

A summary of the changes in stockholders equity for the six months ended June 30, 2009 consisted of the following (in millions):

Stockholders equity, December 31, 2008	$ 2,108.6
Common stock issued under employee plans	10.1
Increase in additional paid-in capital for share-based compensation plans	9.6
Net income	102.1
Other comprehensive loss	3.5
Tax benefit from employee stock plans	0.4
Repurchase of common stock	(2.2)
Stockholders equity, June 30, 2009	$ 2,232.1

NOTE 9 FAIR VALUE MEASUREMENT

In September 2006, the FASB issued SFAS 157 which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair-value measurements. The Company adopted SFAS 157 effective January 1, 2008 for all financial assets and liabilities and any other assets and liabilities that are recognized or disclosed at fair value on a recurring basis. The Company adopted SFAS 157 for nonfinancial assets and liabilities measured at fair value on a non-recurring basis effective January 1, 2009. Although the adoption of SFAS 157 did not materially impact the Company s financial condition, results of operations or cash flows, we are required to provide additional disclosures within our condensed consolidated financial statements.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer the liability (an exit price) in an orderly transaction between market participants and also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy within SFAS 157 distinguishes three levels of inputs that may be utilized when measuring fair value including level 1 inputs (using quoted prices in active markets for identical assets or liabilities), level 2 inputs (using inputs other than level 1 prices such as quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability) and level 3 inputs (unobservable inputs supported by little or no market activity based on our own assumptions used to measure assets and liabilities). A financial asset or liability s classification within the above hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

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Financial assets and liabilities measured at fair value or disclosed at fair value consisted of the following (in millions):

	Fair Value Measurements as at June 30, 2009 Using:			
	Total	**Level 1**	**Level 2**	**Level 3**
Marketable securities	$13.4	$13.4	$	$
Investments	0.2	0.2		

	Fair Value Measurements as at December 31, 2008 Using:			
	Total	**Level 1**	**Level 2**	**Level 3**
Marketable securities	$ 13.2	$ 13.2	$	$
Investments	0.2	0.2		

Marketable securities and investments consist of available-for-sale investments in U.S. Treasury and agency securities and publicly traded equity securities for which market prices are readily available. Unrealized gains or losses on marketable securities and investments are recorded in accumulated other comprehensive income (loss).

NOTE 10 CONTINGENCIES

Legal Matters

Watson and its affiliates are involved in various disputes, governmental and/or regulatory inspections, inquires, investigations and proceedings, and litigation matters that arise from time to time in the ordinary course of business. The process of resolving matters through litigation or other means is inherently uncertain and it is possible that an unfavorable resolution of these matters will adversely affect the Company, its results of operations, financial condition and cash flows. The Company s regular practice is to expense legal fees as services are rendered in connection with legal matters, and to accrue for liabilities when losses are probable and reasonably estimable.

Cipro® Litigation. Beginning in July 2000, a number of suits were filed against Watson, The Rugby Group, Inc. (Rugby) and other company affiliates in various state and federal courts alleging claims under various federal and state competition and consumer protection laws. Several plaintiffs have filed amended complaints and motions seeking class certification. Approximately 42 cases had been filed against Watson, Rugby and other Watson entities. Twenty-two of these actions have been consolidated in the U.S. District Court for the Eastern District of New York (*In re: Ciprofloxacin Hydrochloride Antitrust Litigation, MDL Docket No. 001383*). On May 20, 2003, the court hearing the consolidated action granted Watson s motion to dismiss and made rulings limiting the theories under which plaintiffs can seek recovery against Rugby and the other defendants. On March 31, 2005, the court hearing the consolidated action granted summary judgment in favor of the defendants on all of plaintiffs claims, denied the plaintiffs motions for class certification, and directed the clerk of the court to close the case. On May 7, 2005, three groups of plaintiffs from the consolidated action (the direct purchaser plaintiffs, the indirect purchaser plaintiffs and plaintiffs Rite Aid and CVS) filed notices of appeal in the United States Court of Appeals for the Second Circuit, appealing, among other things, the May 20, 2003 order dismissing Watson and the March 31, 2005 order granting summary judgment in favor of the defendants. The three appeals were consolidated by the appellate court. On August 25, 2005, the defendants moved to transfer the appeals to the United States Court of Appeals for the Federal Circuit on the ground that patent issues are involved in the appeal. On November 7, 2007, the motions panel of the U.S. Court of Appeals for the Second Circuit granted the motion in part, and ordered the appeal by the indirect purchaser plaintiffs transferred to the United States Court of Appeals for the Federal Circuit. On October 15, 2008, the United States Court of Appeals for the Federal Circuit affirmed the dismissal of the indirect purchasers claims, and on December 22, 2008, denied the indirect purchaser plaintiffs petition for rehearing and rehearing en banc. On March 23, 2009, the indirect purchaser

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plaintiffs filed a petition for writ of certiorari with the United States Supreme Court. On June 22, 2009, the Supreme Court denied the petition. In the appeal in the United States Court of Appeals for the Second Circuit by the direct purchaser plaintiffs and plaintiffs CVS and Riteaid, the Second Circuit heard oral argument by the parties on April 28, 2009, and advised the parties that the court had invited the United States Department of Justice to provide comments on the case. On July 6, 2009, the Department of Justice submitted a brief on the matter, expressing no opinion on the Cipro action but suggesting certain standards to evaluate reverse payment patent settlements. The parties responses to the Department of Justice s brief are due to be filed on August 12, 2009. Other actions are pending in various state courts, including New York, California, Kansas, Tennessee, and Florida. The actions generally allege that the defendants engaged in unlawful, anticompetitive conduct in connection with alleged agreements, entered into prior to Watson s acquisition of Rugby from Sanofi Aventis (Aventis), related to the development, manufacture and sale of the drug substance ciprofloxacin hydrochloride, the generic version of Bayer s brand drug, Cipro®. The actions generally seek declaratory judgment, damages, injunctive relief, restitution and other relief on behalf of certain purported classes of individuals and other entities. The court hearing the case in New York has dismissed the action. Appellants have sought leave to appeal the dismissal of the New York action to the New York Court of Appeals. On April 18, 2006, the New York Supreme Court, Appellate Division, denied the appellants motion. In the action pending in Kansas, the court has stayed the matter pending the outcome of the appeal in the consolidated case. In the action pending in the California Superior Court for the County of San Diego (*In re: Cipro Cases I & II, JCCP Proceeding Nos. 4154 & 4220*), on July 21, 2004, the California Court of Appeal granted in part and denied in part the defendants petition for a writ of mandate seeking to reverse the trial court s order granting the plaintiffs motion for class certification. Pursuant to the appellate court s ruling, the majority of the plaintiffs will be permitted to pursue their claims as a class. The defendants have filed motions for summary judgment, which are scheduled to be argued to the Superior Court during the third quarter of 2009. The trial is scheduled for January 25, 2010. In addition to the pending actions, Watson understands that various state and federal agencies are investigating the allegations made in these actions. Aventis has agreed to defend and indemnify Watson and its affiliates in connection with the claims and investigations arising from the conduct and agreements allegedly undertaken by Rugby and its affiliates prior to Watson s acquisition of Rugby, and is currently controlling the defense of these actions.

Governmental Reimbursement Investigations and Drug Pricing Litigation In November 1999, Schein Pharmaceutical, Inc., now known as Watson Pharma, Inc. (Watson Pharma) was informed by the U.S. Department of Justice that Watson Pharma, along with numerous other pharmaceutical companies, is a defendant in a *qui tam* action brought in 1995 under the U.S. False Claims Act currently pending in the U.S. District Court for the Southern District of Florida. Watson Pharma has not been served in the *qui tam* action. A *qui tam* action is a civil lawsuit brought by an individual or a company (the qui tam relator) for an alleged violation of a federal statute, in which the U.S. Department of Justice has the right to intervene and take over the prosecution of the lawsuit at its option. Pursuant to applicable federal law, the *qui tam* action is under seal as to Watson Pharma. The Company believes that the *qui tam* action relates to whether allegedly improper price reporting by pharmaceutical manufacturers led to increased payments by Medicare and/or Medicaid. The *qui tam* action may seek to recover damages from Watson Pharma based on its price reporting practices. Watson Pharma subsequently also received and responded to notices or subpoenas from the Attorneys General of various states, including Florida, Nevada, New York, California and Texas, relating to pharmaceutical pricing issues and whether allegedly improper actions by pharmaceutical manufacturers led to excessive payments by Medicare and/or Medicaid. On June 26, 2003, the Company received a request for records and information from the U.S. House Committee on Energy and Commerce in connection with that committee s investigation into pharmaceutical reimbursements and rebates under Medicaid. The Company produced documents in response to the request. Other state and federal inquiries regarding pricing and reimbursement issues are anticipated.

Beginning in July 2002, the Company and certain of its subsidiaries, as well as numerous other pharmaceutical companies, were named as defendants in various state and federal court actions alleging improper or fraudulent reporting practices related to the reporting of average wholesale prices and wholesale acquisition costs of certain products, and that the defendants committed other improper acts in order to increase prices and market shares. Some of these actions have been consolidated in the U.S. District Court for the District of Massachusetts (*In re: Pharmaceutical Industry Average Wholesale Price Litigation, MDL Docket No. 1456*). The

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consolidated amended Class Action complaint in that case alleges that the defendants acts improperly inflated the reimbursement amounts paid by various public and private plans and programs. The amended complaint alleges claims on behalf of a purported class of plaintiffs that paid any portion of the price of certain drugs, which price was calculated based on its average wholesale price, or contracted with a pharmacy benefit manager to provide others with such drugs. The Company filed an Answer to the Amended Consolidated Class Action Complaint on April 9, 2004. Defendants in the consolidated litigation have been divided into two groups. Certain defendants, referred to as the Track One defendants, have proceeded on an expedited basis. Classes were certified against these defendants, a trial has been completed with respect to some of the claims against this group of defendants, the presiding judge has issued a ruling granting judgment to the plaintiffs, that judgment is being appealed, and many of the claims have been settled. Other defendants, referred to as the Track Two Defendants , including the Company, have entered into a settlement agreement resolving all claims against the Track Two Defendants in the Consolidated Class Action. The total amount of the settlement for all of the Track Two Defendants is $125 million. The amount to be paid by each Track Two Defendant is confidential. On July 2, 2008, the United States District Court for the District of Massachusetts preliminarily approved the Track Two settlement. On April 27, 2009, the Court held a hearing to further consider the fairness of the proposed Track Two settlement. The Court adjourned the hearing without ruling on the fairness of the proposed settlement until additional notices are provided to certain of the class members in the action. The settlement is not expected to materially adversely affect the Company s business, results of operations, financial condition and cash flows.

The Company and certain of its subsidiaries also are named as defendants in various lawsuits filed by numerous states and qui tam relators, including Texas, Kansas, Nevada, Montana, Massachusetts, Wisconsin, Kentucky, Alabama, Illinois, Mississippi, Florida, Arizona, Missouri, Alaska, Idaho, South Carolina, Hawaii, Utah, and Iowa captioned as follows: *State of Nevada v. American Home Products, et al., Civil Action No. 02-CV-12086-PBS, United States District Court for the District of Massachusetts; State of Montana v. Abbott Laboratories, et al., Civil Action No. 02-CV-12084-PBS, United States District Court for the District of Massachusetts; Commonwealth of Massachusetts v. Mylan Laboratories, et al., Civil Action No. 03-CV-11865-PBS, United States District Court for the District of Massachusetts; State of Wisconsin v. Abbott Laboratories, et al., Case No. 04-cv-1709, Wisconsin Circuit Court for Dane County; Commonwealth of Kentucky v. Alpharma, Inc., et al., Case Number 04-CI-1487, Kentucky Circuit Court for Franklin County; State of Alabama v. Abbott Laboratories, Inc. et al., Civil Action No. CV05-219, Alabama Circuit Court for Montgomery County; State of Illinois v. Abbott Laboratories, Inc. et al., Civil Action No. 05-CH-02474, Illinois Circuit Court for Cook County; State of Mississippi v. Abbott Laboratories, Inc. et al., Civil Action No. G2005-2021 S/2, Mississippi Chancery Court of Hinds County; State of Florida ex rel. Ven-A-Care, Civil Action No 98-3032G, Florida Circuit Court in Leon County; State of Arizona ex rel. Terry Goddard, No. CV 2005-18711, Arizona Superior Court for Maricopa County; State of Missouri ex rel. Jeremiah W. (Jay) Nixon v. Mylan Laboratories, et al, Case No. 054-2486, Missouri Circuit Court of St. Louis; State of Alaska v. Alpharma Branded Products Division Inc., et al., In the Superior Court for the State of Alaska Third Judicial District at Anchorage, C.A. No. 3AN-06-12026 CI; State of Idaho v. Alpharma USPD Inc. et al., In the District Court of the Fourth Judicial District of the State of Idaho, in and for the County of Ada, C.A. No. CV0C-0701847; State of South Carolina and Henry D. McMaster v. Watson Pharmaceuticals (New Jersey), Inc., In the Court of Common Pleas for the Fifth Judicial Circuit, State of South Carolina, County of Richland, C.A. No. 2006-CP-40-7152; State of South Carolina and Henry D. McMaster v. Watson Pharmaceuticals (New Jersey), Inc., In the Court of Common Pleas for the Fifth Judicial Circuit, State of South Carolina, County of Richland, C.A. No. 2006-CP-40-7155; State of Hawaii v. Abbott Laboratories, Inc. et al., In the Circuit Court of the First Circuit, State of Hawaii, C.A. No. 06-1-0720-04 EEH; State of Utah v. Actavis U.S., Inc., et al., In the Third Judicial District Court of Salt Lake County, Civil No. 07-0913719; State of Iowa v. Abbott Laboratories, Inc., et al., In the U.S. District Court for the Southern District of Iowa, Central Division, Case No. 07-CV-00461; State of Texas ex rel. Ven-A-Care of the Florida Keys, Inc. v. Alpharma Inc., et al, Case No. 08-001565, in the District Court of Travis County, Texas; and United States of America ex rel. Ven-A-Care of the Florida Keys, Inc., Civil Action No. 08-10852, in the U.S. District Court for the District of Massachussetts and State of Kansas ex rel. Steve Six v. Watson Pharmaceuticals, Inc. and Watson Pharma, Inc., Case Number: 08CV2228, District Court of Wyandotte County, Kansas, Civil Court Department.*

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These cases generally allege that the defendants caused the states to overpay pharmacies and other providers for prescription drugs under state Medicaid Programs by inflating the reported average wholesale price or wholesale acquisition cost, and by reporting false prices to the United States government under the Best Prices rebate program. Several of these cases also allege that state residents were required to make inflated copayments for drug purchases under the federal Medicare program, and companies were required to make inflated payments on prescription drug purchases for their employees. Many of these cases, some of which have been removed to federal court, are in the early stages of pleading or are proceeding through pretrial discovery. On January 20, 2006, the Company was dismissed without prejudice from the actions brought by the States of Montana and Nevada because the Company was not timely served. In the case brought on behalf of the Commonwealth of Massachusetts the Court recently denied cross-motions for summary judgment. The case brought against the Company on behalf of Arizona was settled in May 2009 and was dismissed with prejudice on June 29, 2009. The case brought against the Company on behalf of Alabama was tried in June and July of 2009. At the conclusion of the trial, the jury was unable to reach a verdict, and the court declared a mistrial and ordered the case to be retried. A new trial is scheduled for December 7, 2009. The case brought against the Company on behalf of Hawaii has been scheduled for trial in October 2009. The case brought against the Company on behalf of Kentucky has been scheduled for trial in 2010.

The City of New York filed an action in the United States District Court for the Southern District of New York on August 4, 2004, against the Company and numerous other pharmaceutical defendants alleging similar claims. The case was transferred to the United States District Court for the District of Massachusetts, and was consolidated with several similar cases filed by individual New York counties. A corrected Consolidated Complaint was filed on June 22, 2005 (*City of New York v. Abbott Laboratories, Inc., et al., Civil Action No. 01-CV-12257-PBS, United States District Court for the District of Massachusetts*). The Consolidated Complaint included as plaintiffs the City of New York and 30 New York counties. Since the filing of the Consolidated Complaint, cases brought by a total of 14 additional New York counties have been transferred to the District of Massachusetts. In February 2007, three of the New York counties cases were sent back to New York state court (Erie, Oswego and Schenectady counties). On April 5, 2007, an additional action raising similar allegations was filed by Orange County, New York (*County of Orange v. Abbott Laboratories, Inc., et al.*, *United States District Court for the Southern District of New York, Case No. 07-CV-2777*). The Company is therefore named as a defendant by the City of New York and 41 New York counties, consolidated in the District of Massachusetts case, as well as by four additional New York counties, with three of these cases pending in New York state courts. Many of the state and county cases are included in consolidated or single-case mediation proceedings, and the Company is participating in these proceedings.

Additional actions by other states, cities and/or counties are anticipated. These actions and/or the actions described above, if successful, could adversely affect the Company and may have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

FDA Matters. In May 2002, Watson reached an agreement with the FDA on the terms of a consent decree with respect to its Corona, California manufacturing facility. The court approved the consent decree on May 13, 2002 (*United States of America v. Watson Laboratories, Inc., and Allen Y. Chao*, United States District Court for the Central District of California, EDCV-02-412-VAP). The consent decree with the FDA does not require any fine, a facility shutdown, product recalls or any reduction in production or service at the Company s Corona facility. The consent decree applies only to the Corona facility and not other manufacturing sites. On July 9, 2008, the court entered an order dismissing Allen Y. Chao, the Company s former President and Chief Executive Officer, from the action and from the consent decree. The decree requires Watson to ensure that its Corona, California facility complies with the FDA s current Good Manufacturing Practices (cGMP) regulations.

Pursuant to the agreement, Watson hired an independent expert to conduct inspections of the Corona facility at least once each year. In December 2002, February 2003, January 2004, January 2005, January 2006, January 2007, January-February 2008, and January 2009, respectively, the first, second, third, fourth, fifth, sixth and seventh annual inspections were completed and the independent expert submitted its report of the inspection to the FDA. In each instance, the independent expert reported its opinion that, based on the findings of the audit

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of the facility, the FDA s applicable cGMP requirements, applicable FDA regulatory guidance, and the collective knowledge, education, qualifications and experience of the expert s auditors and reviewers, the systems at Watson s Corona facility audited and evaluated by the expert are in compliance with the FDA s cGMP regulations. However, the FDA is not required to accept or agree with the independent expert s opinion. The FDA conducted an inspection of that facility from March 31, 2004 until May 6, 2004. At the conclusion of the inspection, the FDA issued a Form 483 listing the observations made during the inspection, including observations related to certain laboratory test methods and other procedures in place at the facility. In June 2004 the Company submitted its response to the FDA Form 483 inspectional observations and met with FDA officials to discuss its response, including the corrective actions the Company had taken, and intended to take, to address the inspectional observations. The FDA conducted another inspection of the facility from April 5, 2005 through April 13, 2005. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. The FDA conducted another inspection of the facility from July 10, 2006 through July 21, 2006. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. From February 20, 2007 through March 9, 2007, the FDA conducted another inspection of the facility. At the conclusion of the inspection, the FDA issued a Form 483 listing the observations made during the inspection. In March 2007 the Company submitted its response to the FDA Form 483 inspectional observations, including the corrective actions the Company has taken to address the inspectional observations. The FDA conducted another inspection of the facility from October 18, 2007 through October 26, 2007. At the conclusion of the inspection, the FDA issued a Form 483 listing two observations made during the pre-approval portion of the inspection related to two pending Abbreviated New Drug Applications (ANDAs). No formal observations were made concerning the Company s compliance with cGMP. The FDA conducted another inspection of the facility from June 16, 2008 through July 1, 2008. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. However, if in the future, the FDA determines that, with respect to its Corona facility, Watson has failed to comply with the consent decree or FDA regulations, including cGMPs, or has failed to adequately address the observations in the Form 483, the consent decree allows the FDA to order Watson to take a variety of actions to remedy the deficiencies. These actions could include ceasing manufacturing and related operations at the Corona facility, and recalling affected products. Such actions, if taken by the FDA, could have a material adverse effect on the Company, its results of operations, financial position and/or cash flows.

Federal Trade Commission Investigations. The Company has received Civil Investigative Demands or requests for information from the Federal Trade Commission seeking information and documents related to the terms on which the Company has settled lawsuits initiated by patentees under the Hatch-Waxman Act, and other commercial arrangements between the Company and third parties. These investigations relate to the Company s August 2006 settlement with Cephalon, Inc. related to the Company s generic version of Provigil® (modafinil), and its April 2007 agreement with Sandoz, Inc. related to the Company s forfeiture of its entitlement to 180 days of marketing exclusivity for its 50 milligram dosage strength of its generic version of Toprol XL® (metoprolol xl). The Company believes these agreements comply with applicable laws and rules. However, if the Federal Trade Commission concludes that any of these agreements violate applicable antitrust laws or rules, it could initiate legal action against the Company. These actions, if successful, could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

Androgel® Antitrust Litigation. On January 29, 2009, the U.S. Federal Trade Commission and the State of California filed a lawsuit in the United States District Court for the Central District of California (*Federal Trade Commission, et. al. v. Watson Pharmaceuticals, Inc., et. al., USDC Case No. CV 09-00598)* alleging that the Company s September 2006 patent lawsuit settlement with Solvay Pharmaceuticals, Inc., related to AndroGel® 1% (testosterone gel) CIII is unlawful. The complaint generally alleges that the Company improperly delayed its launch of a generic version of Androgel® in exchange for Solvay s agreement to permit the Company to co-promote Androgel® for consideration in excess of the fair value of the services provided by the Company. The complaint alleges violation of federal and state antitrust and consumer protection laws and seeks equitable relief and civil penalties. On February 2 and 3, 2009, three separate lawsuits alleging similar claims were filed in the United States District Court for the Central District of California by various private plaintiffs purporting to represent certain classes of similarly situated claimants. *(Meijer, Inc., et. al., v. Unimed Pharmaceuticals, Inc., et.*

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al., USDC Case No. EDCV 09-0215); (Rochester Drug Co-Operative, Inc. v. Unimed Pharmaceuticals Inc., et. al., Case No. EDCV 09-0226); (Louisiana Wholesale Drug Co. Inc. v. Unimed Pharmaceuticals Inc., et. al, Case No. EDCV 09-0228). On February 27, 2009, the defendants (including the Company) filed motions to transfer all of the actions pending in the United States District Court for the Central District of California to the United States District Court for the Northern District of Georgia. On April 8, 2009, the Court granted the defendants motion to transfer and transferred the cases to the Northern District of Georgia. On April 21, 2009 the State of California voluntarily dismissed its lawsuit against the Company without prejudice. The Federal Trade Commission and the private plaintiffs in the Northern District of Georgia filed amended complaints on May 28, 2009. The private plaintiffs amended their complaints to include allegations concerning conduct before the U.S. Patent and Trademark Office, conduct in connection with the listing of Solvay s patent in the Food and Drug Administration s Orange Book, and sham litigation. On July 17, 2009, the judge presiding over the Federal Trade Commission action and the private actions in the Northern District of Georgia denied the Federal Trade Commission s motion for a stay of the proceedings and vacated a previously entered stay in the private actions. On July 20, 2009, the defendants (including the Company) filed motions to dismiss the Federal Trade Commission action. On March 31, April 17, and April 21, 2009, additional actions alleging similar claims were filed in the United States District Court for the District of New Jersey (*Stephen L. LaFrance Pharm., Inc. d/b/a SAJ Dist. v. Unimed Pharms., Inc., et al., Civ. No. 09-1507*); (*Fraternal Order of Police, Fort Lauderdale Lodge 31, Insurance Trust Fund v. Unimed Pharms. Inc., et al., Civ. No. 09-1856*); (*Scurto v. Unimed Pharms., Inc., et al., Civ. No. 09-1900*). These actions purport to assert similar claims on behalf of various class representatives. On April 20, 2009, the Company was dismissed without prejudice from the *Stephen L. LaFrance* action pending in the District of New Jersey. On May 8, 2009, the defendants (including the Company) filed motions to transfer all of the actions pending in the United States District Court for the District of New Jersey to the Northern District of Georgia. On June 2, 2009, a District of New Jersey magistrate judge granted the defendants motion to transfer, and denied the plaintiffs motion for reconsideration of that decision on June 24, 2009. On July 13, 2009, the plaintiffs appealed the magistrate judge s decision transferring the cases to the district court judge. On April 8, 2009, the *Stephen L. LaFrance* plaintiffs filed a motion to have all of the private plaintiff cases consolidated under the Multidistrict Litigation rules of the federal courts. The Judicial Panel on Multidistrict Litigation denied the motion as moot on June 5, 2009, and denied the *Stephen L. LaFrance* plaintiffs motion for reconsideration of that decision on June 8, 2009. On May 19, 2009, an additional action alleging similar claims was filed in the District of Minnesota (*United Food and Commercial Workers Unions and Employers Midwest Health Benefits Fund v. Unimed Pharms., Inc., et al., Civ. No. 09-1168*). This action purports to assert similar claims on behalf of a putative class of indirect purchasers of AndroGel®. On June 10, 2009, the defendants (including the Company) filed a motion to transfer the *United Food and Commercial Workers* action to the Northern District of Georgia. On July 16, 2009, the District of Minnesota court ordered a sixty day stay on the briefing for this motion. On June 11, 2009, the *United Food and Commercial Workers* plaintiff filed a motion to have all of the private plaintiff cases consolidated under the Multidistrict Litigation rules of the federal courts. On June 17 and 29, 2009, two additional actions alleging similar claims were filed in the Middle District of Pennsylvania (*Rite Aid Corp. et al. v. Unimed Pharms., Inc. et al., Civ. No. 09-1153,* and *Walgreen Co., et al. v. Unimed Pharms., Inc., et al., Civ. No. 09-1240*), by plaintiffs purporting to be direct purchasers of AndroGel®. On June 22, 2009, the *Rite Aid* plaintiffs filed a motion to have all of the private plaintiff cases consolidated under the Multidistrict Litigation rules of the federal courts. On July 22, 2009, the defendants (including the Company) filed motions to transfer the *Rite Aid* and *Walgreen* actions from the Middle District of Pennsylvania to the Northern District of Georgia. All of these lawsuits are at the pleading stages, and additional actions are anticipated. The Company believes that these actions are without merit and intends to defend itself vigorously. However, these actions, if successful, could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

Department of Health and Human Services Subpoena. In December 2003, the Company s subsidiary, Watson Pharma, received a subpoena from the Office of the Inspector General (OIG) of the Department of Health and Human Services. The subpoena requested documents relating to physician meetings conducted during 2002 and 2003 related to Watson Pharma s Ferrlecit® intravenous iron product. Watson Pharma provided the requested documents and has not been contacted again by the OIG for several years. However, the Company cannot predict

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what additional actions, if any, may be taken by the OIG, Department of Health and Human Services, or other governmental entities.

Hormone Replacement Therapy Litigation. Beginning in early 2004, a number of product liability suits were filed against the Company and certain Company affiliates, for personal injuries allegedly arising out of the use of hormone replacement therapy products, including but not limited to estropipate and estradiol. These complaints also name numerous other pharmaceutical companies as defendants, and allege various injuries, including ovarian cancer, breast cancer and blood clots. Approximately 105 cases are pending against Watson and/or its affiliates in state and federal courts representing claims by approximately 112 plaintiffs. Many of the cases involve multiple plaintiffs. The majority of the cases have been transferred to and consolidated in the United States District Court for the Eastern District of Arkansas (*In re: Prempro Products Liability Litigation, MDL Docket No. 1507*). Discovery in these cases is ongoing. The Company maintains product liability insurance against such claims. However, these actions, if successful, or if insurance does not provide sufficient coverage against the claims, could adversely affect the Company and could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

Levonorgestrel/Ethinyl Estradiol Tablets (Seasonale®). On December 13, 2007, Duramed Pharmaceuticals, Inc. sued the Company and certain of its subsidiaries in the United States District Court for the District of New Jersey, alleging that sales of the Company s Quasense™ (levonorgestrel/ethinyl estradiol) tablets, the generic version of Duramed s Seasonale® tablets, infringes Duramed s U.S. Patent No. RE 39,861 (*Duramed Pharmaceuticals, Inc. v. Watson Pharmaceuticals, Inc., et. al., Case No. 07cv05941*). The complaint seeks damages and injunctive relief. On March 3, 2008, the Company answered the complaint. Discovery is ongoing. The Company believes it has substantial meritorious defenses to the case. However, the Company has sold and is continuing to sell its generic version of Seasonale ®. Therefore, an adverse determination could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

Ferrlecit®. On March 28, 2008, we received a notice from Aventis contending that the distribution agreement for Ferrlecit ® between certain affiliates of Aventis and the Company expires on February 18, 2009. The letter also acknowledged the Company s position that the distribution agreement expires on December 31, 2009, and requested to conduct an expedited arbitration proceeding to resolve the dispute. On April 9, 2008, the Company responded to Aventis, agreeing to arbitrate the disputes related to Ferrlecit ® on an expedited basis. The arbitration was conducted in April 2009 and the arbitration panel issued its decision on May 18, 2009, finding that the distribution agreement for Ferrlecit® expires on December 31, 2009, and affirming the Company s right to continue to distribute Ferrlecit until the end of 2009. The Company does not expect to extend the distribution agreement for Ferrlecit® beyond the end of 2009.

Oxytrol® Litigation. (*Watson Laboratories, Inc. v. Barr Laboratories, Inc., et al. Case No. 08-793*) In September 2008, the Company received a notice letter from Barr Laboratories, Inc. (Barr Labs) stating that Barr Labs had filed an ANDA with the FDA seeking approval of a generic version of the Company s Oxytrol (oxybutynin transdermal system) product. Barr Labs notice letter included a certification under the Hatch- Waxman Act contending that patents listed in the FDA Orange Book for the Company s Oxytrol product are invalid or not infringed by Barr Labs ANDA. On October 23, 2008, the Company s subsidiary, Watson Laboratories, Inc., filed suit against Barr Labs and its parent company, Barr, in the United States District Court for the District of Delaware, alleging that Barr Labs generic version of Oxytrol infringes the Company s patents. Under applicable law, the filing of the lawsuit stays any FDA approval of Barr Labs ANDA until the earlier of a District Court judgment in Barr Labs favor, or thirty months from the date the Company received Barr Labs notice letter. The Company believes it has substantial, meritorious claims against Barr Labs. However, if Barr Labs succeeds in obtaining final FDA approval of a generic version of Oxytrol and commences sales of its product, the Company s business, results of operations, financial condition and cash flows could be materially adversely affected.

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Watson and its affiliates are involved in various other disputes, governmental and/or regulatory inspections, inquires, investigations and proceedings that could result in litigation, and other litigation matters that arise from time to time.

The process of resolving matters through litigation or other means is inherently uncertain and it is possible that an unfavorable resolution of these matters will adversely affect the Company, its results of operations, financial condition and cash flows.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and the results of operations should be read in conjunction with the Condensed Consolidated Financial Statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q (Quarterly Report). This discussion contains forward-looking statements that are subject to known and unknown risks, uncertainties and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements. These risks, uncertainties and other factors include, among others, those identified under Cautionary Note Regarding Forward-Looking Statements under Risks Related to our Business in our Annual Report on Form 10-K for the year ended December 31, 2008 and elsewhere in this Quarterly Report and our Annual Report on Form 10-K.

Overview

Watson Pharmaceuticals, Inc. (Watson , the Company we , us or our) was incorporated in 1985 and is engaged development, manufacturing, marketing, sale and distribution of brand and off-patent (generic) pharmaceutical products. Watson operates manufacturing, distribution, research and development (R&D) and administrative facilities predominantly in the United States (U.S.) and India with our key commercial market being the U.S.

On June 17, 2009, the Company announced a definitive agreement (the Acquisition Agreement) to acquire privately held Arrow Group for cash, stock and certain contingent consideration (the Arrow Acquisition). The Arrow Acquisition will result in a global pharmaceutical company with over $3 billion in revenue, commercial operations in over 20 countries, and a robust product portfolio and pipeline. The Company expects the transaction to close in the second half of 2009. Under the terms of the Agreement, the Company will acquire all the outstanding shares of common stock of the Arrow Group for the following consideration:

A cash payment of U.S. $1.05 billion at closing of the share purchase (the Closing);

Approximately 16.9 million restricted shares of Common Stock of Watson issued at the Closing;

$200.0 million face amount of newly-designated non-voting Series A Preferred Stock of Watson issued at the Closing; and

Certain contingent payments made after the Closing based on the after-tax gross profits on sales of Atorvastatin in the United States as described in the Acquisition Agreement.

The Company intends to fund the cash portion of the consideration by using available cash and additional borrowings. The Company is evaluating options for longer-term debt financing. The following discussion does not include or incorporate the anticipated impact of the Arrow Acquisition on our business, results of operations, financial condition, cash flows or expectations for the remainder of 2009.

Results of Operations

Prescription pharmaceutical products in the U.S. are generally marketed as either generic or brand pharmaceuticals. Generic pharmaceutical products are bioequivalents of their respective brand products and provide a cost-efficient alternative to brand products. Brand pharmaceutical products are marketed under brand names through programs that are designed to generate physician and consumer loyalty.

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Watson has three reportable operating segments: Generic, Brand and Distribution. The Generic segment includes pharmaceutical products that are therapeutically equivalent to proprietary products. The Brand segment includes the Company s Specialty Products and Nephrology/Medical product lines. Watson has aggregated its brand product lines in a single segment because of similarities in regulatory environment, methods of distribution and types of customer. This segment includes patent-protected products and certain trademarked off-patent products that Watson sells and markets as brand pharmaceutical products. The Company sells its brand and generic products primarily to pharmaceutical wholesalers, drug distributors and chain drug stores. The Distribution segment mainly distributes generic pharmaceutical products manufactured by third parties, as well as by Watson, primarily to independent pharmacies, pharmacy chains, pharmacy buying groups and physicians offices under the Anda trade name. Sales are principally generated through an in-house telemarketing staff and through internally developed ordering systems. The Distribution segment operating results exclude sales of Watson products, which are included in their respective Generic and Brand segment results.

The Company evaluates segment performance based on segment net revenues, net revenues less cost of sales and contribution. Segment contribution represents segment net revenues less cost of sales, direct R&D expenses and selling and marketing expenses. The Company has not allocated corporate general and administrative expenses or amortization as such information has not been used by management, or has not been accounted for at the segment level.

Three Months Ended June 30, 2009 Compared to Three Months Ended June 30, 2008

	Three Months Ended June 30, 2009				Three Months Ended June 30, 2008			
	Generic	**Brand**	**Distribution**	**Total**	**Generic**	**Brand**	**Distribution**	**Total**
Product sales	$ 393.8	$ 97.6	$ 161.3	$ 652.7	$ 344.3	$ 101.5	$ 128.0	$ 573.8
Other	7.4	17.7		25.1	32.4	16.5		48.9
Net revenues	401.2	115.3	161.3	677.8	376.7	118.0	128.0	622.7
Operating expenses:								
Cost of sales[(1)]	234.1	22.0	137.0	393.1	227.6	24.4	107.9	359.9
Research and development	29.9	12.7		42.6	29.1	10.1		39.2
Selling and marketing	11.4	39.1	15.7	66.2	13.8	29.6	14.1	57.5
Contribution	$ 125.8	$ 41.5	$ 8.6	175.9	$ 106.2	$ 53.9	$ 6.0	166.1
Contibution margin	31.4%	36.0%	5.3%	26.0%	28.2%	45.7%	4.7%	26.7%
General and administrative				62.1				46.9
Amortization				22.1				20.2
Loss on asset sales				0.2				
Operating income				$ 91.5				$ 99.0
Operating margin				13.5%				15.9%

(1) Excludes amortization of

acquired
intangibles
including
product rights.

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Generic Segment

Net Revenues

Our Generic segment develops, manufactures, markets, sells and distributes generic products that are the therapeutic equivalent to their brand name counterparts and are generally sold at prices significantly less than the brand product. As such, generic products provide an effective and cost-efficient alternative to brand products. When patents or other regulatory exclusivity no longer protect a brand product, opportunities exist to introduce off-patent or generic counterparts to the brand product. Additionally, we distribute generic versions of third parties brand products (sometimes known as Authorized Generics) to the extent such arrangements are complementary to our core business. Our portfolio of generic products includes products we have internally developed, products we have licensed from third parties, and products we distribute for third parties.

Net revenues in our Generic segment include product sales and other revenue. Our Generic segment product line includes a variety of products and dosage forms. Indications for this line include pregnancy prevention, pain management, depression, hypertension and smoking cessation. Dosage forms include oral solids, transdermals, injectables and transmucosals.

Other revenues consist primarily of royalties and commission revenue.

Net revenues from our Generic segment for the three months ended June 30, 2009 increased 6.5% or $24.5 million to $401.2 million compared to net revenues of $376.7 million from the prior year period. This increase in net revenues was mainly attributable to new product launches and products acquired subsequent to the second quarter of 2008 ($58.6 million) offset in part by a decrease in other revenue ($25.0 million) and a decrease in sales of certain oral contraceptives.

The significant portion of the decrease in other revenues in the three months ended June 30, 2009 for the Generic segment was related to the recognition of a $15.0 million milestone obligation in the prior year quarter for a 1999 Schein Pharmaceutical, Inc. (Schein) litigation settlement with Barr Pharmaceuticals, Inc. (Barr) related to Cenestin. Other revenues also declined $6.5 million compared to the prior year quarter due to reduced royalties on sales by Sandoz, Inc. of metoprolol succinate 50 mg extended release tablets and reduced royalties on sales by GlaxoSmithKline of Wellbutrin XL® 150 mg. Sales of metoprolol succinate 50 mg declined as Sandoz, Inc. ceased shipping the product in the fourth quarter of 2008 and it is uncertain when sales will resume. Sales of Wellbutrin XL® 150 mg declined due to increased competition.

Cost of Sales

Cost of sales includes production and packaging costs for the products we manufacture, third party acquisition costs for products manufactured by others, profit-sharing or royalty payments for products sold pursuant to licensing agreements, inventory reserve charges and excess capacity utilization charges, where applicable. Cost of sales does not include amortization costs for acquired product rights or other acquired intangibles.

Cost of sales for our Generic segment increased 2.9% or $6.5 million to $234.1 million in the three months ended June 30, 2009 compared to $227.6 million in the prior year quarter. The increase in cost of sales was primarily due to increased product sales in the current year period partially offset by manufacturing efficiencies as a result of the implementation of our Global Supply Chain Initiative and lower unit manufacturing costs due to higher manufacturing volumes at certain manufacturing sites.

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Research and Development Expenses

Generic segment R&D expenses consist predominantly of personnel-related costs, active pharmaceutical ingredient (API) costs, contract research, biostudy and facilities costs associated with the development of our products.

Generic segment R&D expenses increased 2.7% or $0.8 million to $29.9 million in the three months ended June 30, 2009 compared to $29.1 million in the prior year quarter due to higher R&D costs in India.

Selling and Marketing Expenses

Selling and marketing expenses consist mainly of personnel costs, facilities costs, insurance and professional services costs.

Generic segment selling and marketing expenses decreased 17.8% or $2.4 million to $11.4 million in the three months ended June 30, 2009 compared to $13.8 million in the prior year period due primarily to cost savings as a result of the implementation of our Global Supply Chain Initiative.

Brand Segment

Net Revenues

Our brand pharmaceutical business develops, manufactures, markets, sells and distributes products within two sales and marketing groups: Specialty Products and Nephrology/Medical.

Our Specialty Products product line includes urology products such as, Gelnique™, Rapaflo™ and Trelstar® and a number of non-promoted products.

Our Nephrology/Medical product line consists of products for the treatment of iron deficiency anemia and is generally marketed to nephrologists and dialysis centers. The major products of the Nephrology/Medical group are Ferrlecit® and INFeD®, which are used to treat low iron levels in patients undergoing hemodialysis in conjunction with erythropoietin therapy.

Other revenues in the Brand segment consist primarily of co-promotion revenue, royalties and the recognition of deferred revenue relating to our obligation to manufacture and supply brand products to third parties. Other revenues also include revenue recognized from R&D and licensing agreements.

Net revenues from our Brand segment for the three months ended June 30, 2009 decreased 2.3% or $2.7 million to $115.3 million compared to net revenues of $118.0 million in the prior year period. The decrease was primarily attributable to lower sales within the Nephrology/Medical product line ($12.5 million) which was partially offset by higher sales within the Specialty Products product line ($8.6 million) and higher other revenues ($1.2 million).

The Nephrology/Medical product line experienced declines in sales of both INFeD® and Ferrlecit® during the current year quarter. Lower sales of INFeD® resulted from a supply interruption of INFeD® s API which is available from only one source. We resumed shipments of INFeD® in July 2009. Lower sales of Ferrlecit® resulted from changes in customer buying patterns compared to the prior year quarter and due to a customer transitioning to a competing product in the current year quarter. Further declines in sales to this customer are anticipated until December 31, 2009 at which time our distribution rights for Ferrlecit® terminate. The increase within the Specialty Products product line primarily related to the launch of Rapaflo™ and Gelnique™ during the current year quarter.

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Cost of Sales

Cost of sales includes production and packaging costs for the products we manufacture, third party acquisition costs for products manufactured by others, profit-sharing or royalty payments for products sold pursuant to licensing agreements, inventory reserve charges and excess capacity utilization charges, where applicable. Cost of sales does not include amortization costs for acquired product rights or other acquired intangibles.

Cost of sales for our Brand segment decreased 10.0% or $2.4 million to $22.0 million in the three months ended June 30, 2009 compared to $24.4 million in the prior year period. The decrease in cost of sales was due to lower product sales in the current year period and lower unit manufacturing costs due to higher manufacturing volumes at certain of our manufacturing sites.

Research and Development Expenses

Brand segment R&D expenses consist predominantly of personnel-related costs, contract research, clinical costs and facilities costs associated with the development of our products.

Brand segment R&D expenses increased 25.4% or $2.6 million to $12.7 million in the three months ended June 30, 2009 compared to $10.1 million in the prior year period primarily due to increased clinical spending.

Selling and Marketing Expenses

Brand segment selling and marketing expenses consist mainly of personnel-related costs, product promotion costs, distribution costs, professional services costs, insurance and depreciation.

Brand segment selling and marketing expenses increased 32.3% or $9.5 million to $39.1 million in the three months ended June 30, 2009 as compared to $29.6 million in the prior year period primarily related to increased product promotion, field force and marketing costs to support launch activities related to Rapaflo™ and Gelnique™.

Distribution Segment

Net Revenues

Our Distribution segment mainly distributes generic pharmaceutical products manufactured by third parties, as well as by Watson, primarily to independent pharmacies, pharmacy chains, pharmacy buying groups and physicians offices. Sales are principally generated through an in-house telemarketing staff and through internally developed ordering systems. The Distribution segment operating results exclude Watson generic and brand products, which are included in their respective segment results.

Net revenues from our Distribution segment for the three months ended June 30, 2009 increased 26.1% or $33.3 million to $161.3 million compared to net revenues of $128.0 million in the prior year period primarily due to an increase in net revenues from new products launched during the second quarter of 2009 ($23.1 million) and higher levels of sales in the brand product category in the current year quarter.

Cost of Sales

Cost of sales for our Distribution segment increased 27.0% or $29.1 million to $137.0 million in the three months ended June 30, 2009 compared to $107.9 million in the prior year period. Distribution segment cost of sales increased in the current quarter due to increased sales levels.

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Selling and Marketing Expenses

Selling and marketing expenses consist mainly of personnel costs, facilities costs, insurance and freight costs, which support the Distribution segment sales and marketing functions.

Distribution segment selling and marketing expenses increased 11.7% or $1.6 million to $15.7 million in the three months ended June 30, 2009 as compared to $14.1 million in the prior year period primarily related to higher staffing levels.

Segment Contribution

	Three Months Ended June 30,		Change	
($ in millions):	2009	2008	Dollars	%
Segment contribution				
Generic	$ 125.8	$ 106.2	$ 19.6	18.5%
Brand	41.5	53.9	(12.4)	(23.0)%
Distribution	8.6	6.0	2.6	43.3%
	$ 175.9	$ 166.1	$ 9.8	5.9%
as % of net revenues	*26.0%*	*26.7%*		

For more information on segment contribution, refer to above Management s Discussion and Analysis of Financial Condition and Results of Operations and NOTE 3 OPERATING SEGMENTS in the accompanying Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

Corporate General and Administrative Expenses

	Three Months Ended June 30,		Change	
($ in millions):	2009	2008	Dollars	%
Corporate general and administrative expenses	$ 62.1	$ 46.9	$15.2	32.4%
as a % of net revenues	*9.2%*	*7.5%*		

Corporate general and administrative expenses consists mainly of the cost of personnel, facilities, insurance, professional services and litigation, which is general in nature and not directly related to specific segment operations.

Corporate general and administrative expenses increased during the three months ended June 30, 2009 primarily due to acquisition costs incurred in the current period ($11.9 million) and higher litigation expenses ($3.1 million).

Amortization

	Three Months Ended June 30,		Change	
($ in millions):	2009	2008	Dollars	%
Amortization	$ 22.1	$ 20.2	$1.9	9.4%
as a % of net revenues	*3.3%*	*3.2%*		

The Company s amortizable assets consist primarily of acquired product rights. For the three months ended June 30, 2009 amortization expense increased $1.9 million primarily as a result of the amortization of product rights the Company acquired in the fourth quarter of 2008 as a result of the merger between Teva Pharmaceutical Industries, Ltd. (Teva) and Barr.

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Loss on Asset Sales

	Three Months Ended June 30,		Change	
($ in millions):	2009	2008	Dollars	%
Loss on asset sales	$ 0.2	$	$0.2	100.0%
as a % of net revenues	*0.0%*	*0.0%*		

In the three months ended June 30, 2009, we recognized a $0.2 million loss on the disposal of certain property and equipment related to our business restructuring and facility rationalization activities.

Interest Income

	Three Months Ended June 30,		Change	
($ in millions):	2009	2008	Dollars	%
Interest income	$ 1.3	$ 1.7	$(0.4)	(23.5)%
as a % of net revenues	*0.2%*	*0.3%*		

Interest income decreased for the three months ended June 30, 2009 due to a decrease in interest rates over the prior year period.

Interest Expense

	Three Months Ended June 30,		Change	
($ in millions):	2009	2008	Dollars	%
Interest expense Senior Credit Facility due 2011 (2006 Credit Facility)	$ 1.3	$ 3.7	$ (2.4)	
Interest expense convertible contingent senior debentures due 2023 (CODES)	3.2	3.2		
Interest expense other	0.1		0.1	
Interest expense	$ 4.6	$ 6.9	$ (2.3)	(33.3)%
as a % of net revenues	*0.7%*	*1.1%*		

Interest expense decreased for the three months ended June 30, 2009 due to reduced LIBOR rates of interest on the 2006 Credit Facility during the current year period.

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Other Income

($ in millions):	Three Months Ended June 30, 2009	2008	Change Dollars	%
Earnings on equity method investments	$ 2.4	$ 1.8	$ 0.6	
Other income		0.2	(0.2)	
	$ 2.4	$ 2.0	$ 0.4	20.0%
as a % of net revenues	*0.4%*	*0.3%*		

Earnings on Equity Method Investments

The Company s equity investments are accounted for under the equity-method when the Company s ownership does not exceed 50% and when the Company can exert significant influence over the management of the investee. Earnings on equity method investments primarily represent our share of equity earnings in Scinopharm Taiwan Ltd. (Scinopharm).

Scinopharm results for the three months ended June 30, 2009 were higher than the prior year period due to favorable product mix in the current year quarter.

Provision for Income Taxes

($ in millions):	Three Months Ended June 30, 2009	2008	Change Dollars	%
Provision for income taxes	$ 37.6	$ 35.5	$2.1	5.9%
Effective tax rate	*41.5%*	*37.1%*		

The provision for income taxes differs from the amount computed by applying the statutory U.S. federal income tax rate primarily due to state taxes, non-deductible transaction costs and other factors which, combined, increases the effective tax rate.

The higher effective tax rate for the three months ended June 30, 2009, as compared to the same period of the prior year, primarily reflects the impact of non-deductible transaction costs related to the Arrow Acquisition (5.0%), which was partially offset by a reduction in the effective tax rate for the R&D tax credit and certain permanent differences (0.6%).

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Six Months Ended June 30, 2009 Compared to Six Months Ended June 30, 2008

	Six Months Ended June 30, 2009				Six Months Ended June 30, 2008			
	Generic	**Brand**	**Distribution**	**Total**	**Generic**	**Brand**	**Distribution**	**Total**
Product sales	$ 789.0	$ 195.8	$ 315.0	$ 1,299.8	$ 686.7	$ 200.5	$ 272.9	$ 1,160.1
Other	13.9	31.5		45.4	56.7	32.8		89.5
Net revenues	802.9	227.3	315.0	1,345.2	743.4	233.3	272.9	1,249.6
Operating expenses:								
Cost of sales(1)	472.6	46.2	263.0	781.8	457.3	51.9	230.8	740.0
Research and development	60.0	24.9		84.9	51.7	25.5		77.2
Selling and marketing	24.1	76.0	31.8	131.9	27.9	57.6	28.1	113.6
Contribution	$ 246.2	$ 80.2	$ 20.2	346.6	$ 206.5	$ 98.3	$ 14.0	318.8
Contibution margin	30.7%	35.3%	6.4%	25.8%	27.8%	42.1%	5.1%	25.5%
General and administrative				131.0				97.4
Amortization				43.9				40.4
Gain on asset sales				(1.3)				
Operating income				$ 173.0				$ 181.0
Operating margin				12.9%				14.5%

(1) Excludes amortization of acquired intangibles including product rights.

Generic Segment

Net Revenues

Net revenues from our Generic segment for the six months ended June 30, 2009 increased 8.0% or $59.4 million to $802.8 million compared to net revenues of $743.4 million from the prior year period. This increase in sales was mainly attributable to new product launches and products acquired subsequent to the second quarter of 2008 ($115.5 million) offset in part by a decrease in other revenue ($42.8 million) and a decrease in sales of alendronate sodium tablets due to increased competition.

Of the $42.8 million decrease in other revenue, there was a $22.2 million decline in other revenues compared to the prior year period due to reduced royalties on sales by Sandoz, Inc. of metoprolol succinate 50 mg extended release tablets and reduced royalties on sales by GlaxoSmithKline of Wellbutrin XL® 150 mg. Sales of metoprolol succinate 50 mg declined as Sandoz, Inc. ceased shipping the product in the fourth quarter of 2008 and it is uncertain when sales will resume. Sales of Wellbutrin XL® 150 mg declined due to increased competition. Other revenues also declined as

the prior year period recognized a $15.0 million milestone obligation for a 1999 Schein litigation settlement with Barr related to Cenestin.

Cost of Sales

Cost of sales for our Generic segment increased 3.3% or $15.3 million to $472.6 million in the six months ended June 30, 2009 compared to $457.3 million in the prior year period. The increase in cost of sales was primarily due to higher product sales in the current year period partially offset by manufacturing efficiencies as a result of the implementation of our Global Supply Chain Initiative and higher manufacturing volumes at certain of our manufacturing sites.

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Research and Development Expenses

Generic segment R&D expenses increased 15.9% or $8.3 million to $60.0 million in the six months ended June 30, 2009 compared to $51.7 million in the prior year period due to higher biostudy and test chemical costs ($7.9 million) and increased R&D activities in India.

Selling and Marketing Expenses

Generic segment selling and marketing expenses decreased 13.6% or $3.8 million to $24.1 million in the six months ended June 30, 2009 compared to $27.9 million in the prior year period due primarily to cost savings as a result of the implementation of our Global Supply Chain Initiative.

Brand Segment

Net Revenues

Net revenues from our Brand segment for the six months ended June 30, 2009 decreased 2.6% or $6.0 million to $227.3 million compared to net revenues of $233.3 million in the prior year period. The decrease was primarily attributable to lower sales within the Nephrology/Medical product line ($14.3 million) which was partially offset by higher sales within the Specialty Products product line ($9.6 million).

The Nephrology/Medical product line experienced declines in sales of both INFeD® and Ferrlecit® during the current year period. Lower sales of INFeD® resulted from a supply interruption of INFeD® s API which is available from only one source. We resumed shipments of INFeD® in July 2009. Lower sales of Ferrlecit® resulted from changes in customer buying patterns compared to the prior year period and due to a customer transitioning to a competing product during the current year period. The increase within the Specialty Products product line primarily related to the launch of Rapaflo™ and Gelnique™ and higher sales of certain non-promoted products in the current year period.

Cost of Sales

Cost of sales for our Brand segment decreased 11.0% or $5.7 million to $46.2 million in the six months ended June 30, 2009 compared to $51.9 million in the prior year period. The decrease in cost of sales was primarily due to lower product sales in the current year period and lower unit manufacturing costs due to higher manufacturing volumes at certain manufacturing sites.

Research and Development Expenses

Brand segment R&D expenses decreased 2.3% or $0.6 million to $24.9 million in the six months ended June 30, 2009 compared to $25.5 million in the prior year period.

Selling and Marketing Expenses

Brand segment selling and marketing expenses increased 32.0% or $18.4 million to $76.0 million in the six months ended June 30, 2009 as compared to $57.6 million in the prior year period primarily related to increased product promotion, field force and marketing costs to support launch activities related to Rapaflo™ and Gelnique™.

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Distribution Segment

Net Revenues

Net revenues from our Distribution segment for the six months ended June 30, 2009 increased 15.4% or $42.1 million to $315.0 million compared to net revenues of $272.9 million in the prior year period. The increase was primarily attributable to an increase in net revenues from new products launched after the second quarter of 2008 ($56.2 million) and higher levels of sales in the brand product category ($23.5 million) which was partially offset by lower levels of sales in the current period from price erosion and volume decreases ($38.4 million).

Cost of Sales

Cost of sales for our Distribution segment increased 14.0% or $32.2 million to $263.0 million in the six months ended June 30, 2009 compared to $230.8 million in the prior year period. Distribution segment cost of sales increased in the current year period due to increased sales levels.

Selling and Marketing Expenses

Distribution segment selling and marketing expenses increased 13.1% or $3.7 million to $31.8 million in the six months ended June 30, 2009 as compared to $28.1 million in the prior year period primarily related to higher freight costs ($1.0 million) and higher payroll costs ($2.6 million).

Segment Contribution

	Six Months Ended June 30,		Change	
($ in millions):	**2009**	**2008**	**Dollars**	**%**
Segment contribution				
Generic	$ 246.2	$ 206.5	$ 39.7	19.2%
Brand	80.2	98.3	(18.1)	(18.4)%
Distribution	20.2	14.0	6.2	44.3%
	$ 346.6	$ 318.8	$ 27.8	8.7%
as % of net revenues	*25.8%*	*25.5%*		

For more information on segment contribution, refer to above Management s Discussion and Analysis of Financial Condition and Results of Operations and NOTE 3 OPERATING SEGMENTS in the accompanying Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

Corporate General and Administrative Expenses

	Six Months Ended June 30,		Change	
($ in millions):	**2009**	**2008**	**Dollars**	**%**
Corporate general and administrative expenses	$131.0	$97.4	$33.6	34.5%
as a % of net revenues	*9.7%*	*7.8%*		

Corporate general and administrative expenses increased during the six months ended June 30, 2009 due to a legal settlement of a patent dispute with Elan Corporation, Plc during the current year period ($18.0 million) and due to acquisition costs incurred in the current period ($11.9 million).

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Amortization

($ in millions):	Six Months Ended June 30, 2009	2008	Change Dollars	%
Amortization	$43.9	$40.4	$3.5	8.7%
as a % of net revenues	*3.3%*	*3.2%*		

For the six months ended June 30, 2009 amortization expense increased $3.5 million primarily as a result of the amortization of product rights the Company acquired in the fourth quarter of 2008 as a result of the merger between Teva and Barr.

Gain on Asset Sales

($ in millions):	Six Months Ended June 30, 2009	2008	Change Dollars	%
Gain on asset sales	$ 1.3	$	$1.3	100.0%
as a % of net revenues	*0.1%*	*0.0%*		

In January 2009, we recognized a $1.5 million gain on the sale of certain property and equipment in Dombivli, India for cash consideration of $3.0 million.

Loss on Early Extinguishment of Debt

($ in millions):	Six Months Ended June 30, 2009	2008	Change Dollars	%
Loss on early extinguishment of debt	$	$ 1.1	$(1.1)	(100.0)%
as a % of net revenues	*0.0%*	*0.1%*		

In November 2006, we entered into the 2006 Credit Facility in connection with the acquisition of the Andrx Corporation.

During the period ended June 30, 2008, the Company prepaid $75.0 million of outstanding debt on the 2006 Credit Facility. As a result of this prepayment, our results for the period ended June 30, 2008 reflect debt repurchase charges of $1.1 million which consist of unamortized debt issue costs associated with the repurchased amount.

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Interest Income

($ in millions):	Six Months Ended June 30, 2009	2008	Change Dollars	%
Interest income	$ 3.3	$ 4.0	$(0.7)	(17.5)%
as a % of net revenues	*0.2%*	*0.3%*		

Interest income decreased for the six months ended June 30, 2009 due to a decrease in interest rates over the prior year period.

Interest Expense

	($ in millions):	Six Months Ended June 30, 2009	2008	Change Dollars	%
Interest expense	2006 Credit Facility	$ 2.8	$ 7.6	$ (4.8)	
Interest expense	CODES	6.4	6.3	0.1	
Interest expense	other	0.1	(0.2)	0.3	
Interest expense		$ 9.3	$ 13.7	$ (4.4)	(32.1)%
as a % of net revenues		*0.7%*	*1.1%*		

Interest expense decreased for the six months ended June 30, 2009 due to reduced LIBOR rates of interest on the 2006 Credit Facility during the current year period.

Other Income

($ in millions):	Six Months Ended June 30, 2009	2008	Change Dollars	%
Earnings on equity method investments	$ 4.7	$ 5.8	$ (1.1)	
(Loss) gain on securities	(1.1)	1.4	(2.5)	
Other income		0.2	(0.2)	
	$ 3.6	$ 7.4	$ (3.8)	(51.4)%
as a % of net revenues	*0.3%*	*0.6%*		

Earnings on Equity Method Investments

Scinopharm results for the six months ended June 30, 2008 were higher than the current year period due to product launches at the beginning of 2008.

(Loss) Gain on Securities

In the six months ended June 30, 2009 the Company recorded an other-than-temporary impairment charge of $2.2 million related to our

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investment in common shares of inVentiv Health, Inc. (inVentiv) as the fair value of our investment fell below our carrying value for a six-month period. This loss was partially offset by the receipt of cash proceeds of $1.1 million as additional consideration on the sale of our investment in Adheris, Inc.

In the six months ended June 30, 2008 the Company received common shares of inVentiv and cash as additional proceeds on our sale of our investment in Adheris, Inc. which was recorded as a gain on securities.

Provision for Income Taxes

	Six Months Ended June 30,		Change	
($ in millions):	**2009**	**2008**	**Dollars**	**%**
Provision for income taxes	$68.5	$66.7	$1.8	2.7%
Effective tax rate	*40.1%*	*37.6%*		

The higher effective tax rate for the six months ended June 30, 2009, as compared to the same period of the prior year, primarily reflects the impact of non-deductible transaction costs related to the Arrow Acquisition (2.6%), which was partially offset by a reduction in the effective tax rate for the R&D tax credit and certain permanent differences (0.1%).

Liquidity and Capital Resources

Working Capital Position

Working capital at June 30, 2009 and December 31, 2008 is summarized as follows:

($ in millions):	June 30, 2009	December 31, 2008	Increase (Decrease)
Current Assets:			
Cash and cash equivalents	$ 637.5	$ 507.6	$ 129.9
Marketable securities	13.4	13.2	0.2
Accounts receivable, net of allowances	356.6	305.0	51.6
Inventories	499.3	473.1	26.2
Other	181.7	159.5	22.2
Total current assets	1,688.5	1,458.4	230.1
Current liabilities:			
Accounts payable and accrued expenses	427.1	381.3	45.8
Short-term debt and current portion of long-term debt	726.4	53.2	673.2
Other	37.1	47.5	(10.4)
Total current liabilities	1,190.6	482.0	708.6
Working Capital	$ 497.9	$ 976.4	$ (478.5)
Current Ratio	1.42	3.03	

Watson s primary source of liquidity is cash from operations. Net working capital at June 30, 2009 was $497.9 million, compared to $976.4 million at December 31, 2008. The decline in working capital was due to a reclassification of debt from long-term to current. During the quarter ended March 31, 2009, the CODES debt was reclassified to current liabilities from long-term liabilities as it is our expectation that the Company will redeem the

outstanding amount of the CODES for cash within the next 12 months. At June 30, 2009, $100.0 million of the 2006 Credit Facility was reclassified to current liabilities from long-term liabilities as the Company entered into an amendment to the 2006 Credit Facility on July 1, 2009 which, among other things,

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required the repayment of $100.0 million of the $250.0 million outstanding under the term facility of the 2006 Credit Facility not later than December 16, 2009.

The Company announced the Arrow Acquisition on June 17, 2009. The Company intends to fund the cash portion of the consideration by using available cash and additional borrowings. The Company is evaluating options for longer-term debt financing.

We expect that 2009 cash flows from operating activities will continue to exceed net income. In addition, management expects that cash flows from operating activities, available credit lines, available cash balances and additional borrowings will fund our operating liquidity needs, our debt repurchase obligations and our Arrow Acquisition obligations within the next year.

Cash Flows from Operations

Summarized cash flow from operations is as follows:

	Six months ended June 30,	
($ in millions):	**2009**	**2008**
Net cash provided by operating activities	$161.2	$166.2

Cash flows from operations represent net income adjusted for certain operations related non-cash items and changes in certain assets and liabilities. For the six months ended June 30, 2009, cash provided by operating activities was $161.2 million, compared to $166.2 million in the six months ended June 30, 2008. The Company has generated cash flows from operating activities primarily driven by net income adjusted for amortization of our acquired product rights and depreciation.

Investing Cash Flows

Our cash flows from investing activities are summarized as follows:

	Six months ended June 30,	
($ in millions):	**2009**	**2008**
Net cash used in investing activities	$37.6	$29.4

Investing cash flows consist primarily of expenditures related to capital expenditures, investment and marketable security additions as well as proceeds from investment and marketable security sales. Net cash used in investing activities for the six months ended June 30, 2009 was relatively unchanged from 2008 levels.

Financing Cash Flows

Our cash flows from financing activities are summarized as follows:

	Six months ended June 30,	
($ in millions):	**2009**	**2008**
Net cash provided by (used in) financing activities	$6.3	$(75.9)

Financing cash flows consist primarily of borrowings and repayments of debt, repurchases of common stock and proceeds from exercising of stock awards. For the six months ended June 30, 2009, net cash provided by

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financing activities was $6.3 million compared to $75.9 million used in financing activities during the six months ended June 30, 2008. Cash used in financing activities in the prior year period primarily related to a $75.0 million prepayment of the 2006 Credit Facility. Cash provided by financing activities in the six months ended June 30, 2009 primarily related to proceeds received from stock option exercises.

Debt and Borrowing Capacity

Our outstanding debt obligations are summarized as follows:

($ in millions):	June 30, 2009	December 31, 2008	Increase (Decrease)
Short-term debt and current portion of long-term debt	$ 726.4	$ 53.2	$ 673.2
Long-term debt	150.0	824.7	(674.7)
Total debt	$ 876.4	$ 877.9	$ (1.5)
Debt to capital ratio	28.2%	29.4%	

During the quarter ended March 31, 2009, the CODES debt was reclassified to current liabilities from long-term liabilities as it is our current expectation that the Company will redeem the outstanding amount of the CODES for cash within the next 12 months. At June 30, 2009, $100.0 million of the 2006 Credit Facility was reclassified to current liabilities from long-term liabilities as the Company entered into an amendment to the 2006 Credit Facility which, among other things, required the repayment of $100.0 million of the $250.0 million outstanding under the term facility of the 2006 Credit Facility not later than December 16, 2009.

During the quarter ended March 31, 2008, we prepaid $75.0 million of the amount outstanding under the 2006 Credit Facility. As a result of this prepayment, our results for the first quarter of 2008 reflect a $1.1 million debt repurchase charge. As of June 30, 2009, $50.0 million was outstanding on the revolving credit facility and $250.0 million was outstanding on the senior term loan facility of the 2006 Credit Facility. As indicated above, the amendment to the 2006 Credit Facility requires a $100.0 million principal payment on the term facility of the 2006 Credit Facility in 2009. The remaining amount outstanding on the 2006 Credit Facility is due November 2011.

Under the terms of the 2006 Credit Facility, each of our subsidiaries, other than minor subsidiaries, entered into a full and unconditional guarantee on a joint and several basis. We are subject to, and, as of June 30, 2009, were in compliance with financial and operation covenants under the terms of the 2006 Credit Facility. The agreement currently contains the following financial covenants:

maintenance of a minimum net worth of at least $1.56 billion;

maintenance of a maximum leverage ratio not greater than 2.75 to 1.0; and

maintenance of a minimum interest coverage ratio of at least 5.0 to 1.0.

At June 30, 2009, our net worth was $2.23 billion, and our leverage ratio was 1.45 to 1.0. Our interest coverage ratio for the three months ended June 30, 2009 was 25.3 to 1.0.

Under the 2006 Credit Facility, interest coverage ratio, with respect to any financial covenant period, is defined as the ratio of EBITDA for such period to interest expense for such period. The leverage ratio, for any financial covenant period, is defined as the ratio of the outstanding principal amount of funded debt for the borrower and its subsidiaries at the end of such period, to EBITDA for such period. EBITDA under the 2006 Credit Facility, for any covenant period, is defined as net income plus (1) depreciation and amortization, (2) interest expense, (3) provision for income taxes, (4) extraordinary or unusual losses, (5) non-cash portion of nonrecurring losses and charges, (6) other non-operating, non-cash losses, (7) minority interest expense in respect of equity holdings in affiliates, (8) non-cash expenses relating to stock-based compensation expense and

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(9) any one-time charges related to the acquisition of the Andrx Corporation; minus (1) extraordinary gains, (2) interest income and (3) other non-operating, non-cash income.

Long-term Obligations

At June 30, 2009, there have been no material changes in the Company s enforceable and legally binding obligations, contractual obligations and commitments from those disclosed in our Annual Report on Form 10-K for the period ended December 31, 2008 apart from the amendment to the 2006 Credit Facility which requires a $100.0 million principal payment on the term facility of the 2006 Credit Facility in 2009. This amount was previously listed as being due within 1 to 3 years in the December 31, 2008 Long-term Obligations table.

Recent accounting pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair-Value Measurements, (SFAS 157) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair-value measurements. The Company adopted SFAS 157 effective January 1, 2008 for all financial assets and liabilities and any other assets and liabilities that are recognized or disclosed at fair value on a recurring basis (refer to NOTE 9 FAIR VALUE MEASUREMENT in the accompanying Notes to Condensed Consolidated Financial Statements in this Quarterly Report). For nonfinancial assets and liabilities measured at fair value on a non-recurring basis, SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2008. The adoption of SFAS 157 for nonfinancial assets and liabilities measured at fair value on a non-recurring basis on January 1, 2009 did not have a material impact on our condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141R) which replaces SFAS No. 141, Business Combinations . SFAS 141R establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in a business combination at their fair value at acquisition date. SFAS 141R alters the treatment of acquisition-related costs, business combinations achieved in stages (referred to as a step acquisition), the treatment of gains from a bargain purchase, the recognition of contingencies in business combinations, the treatment of in-process research and development in a business combination as well as the treatment of recognizable deferred tax benefits. SFAS 141R is effective for business combinations closed in fiscal years beginning after December 15, 2008. The Company expects the adoption of SFAS 141R will have a significant impact on the Company s condensed consolidated financial statements upon the closing of the Arrow Acquisition. In the three months ended June 30, 2009, the Company recorded acquisition expenses in the amount of $11.9 million in accordance with SFAS 141R.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51, (SFAS 160). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company currently has no minority interests and accordingly the adoption of SFAS 160 did not have a material impact on our condensed consolidated financial statements. However, SFAS 160 may have an impact on any acquisitions we consummate after January 1, 2009.

In April 2008, the FASB issued FASB Staff Position (FSP) No. FAS 142-3, Determination of the Useful Life of Intangible Assets, (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets, and also requires expanded disclosure related to the determination of intangible asset useful lives. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP 142-3 did not have a material impact on our condensed consolidated financial statements.

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In May 2009, the FASB issued SFAS No. 165, Subsequent Events, (SFAS 165). SFAS 165 establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued. SFAS 165 is effective for financial statements issued for interim or fiscal years ending after June 15, 2009. The adoption of SFAS 165 in the quarter ended June 30, 2009 did not have a material impact on the Company s condensed consolidated financial statements. The Company evaluated all events or transactions that occurred after June 30, 2009 up through July 31, 2009, the date the Company issued these financial statements. During this period, the Company did have a recognizable subsequent event related to the reclassification of $100.0 million in debt to current from noncurrent liabilities as a result of the amendment of the 2006 Credit Facility on July 1, 2009 (refer to NOTE 5 DEBT for additional information). During this period, the Company did not have any material nonrecognizable subsequent events.

In June 2008, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R), (SFAS 167). SFAS 167 is a revision to FIN No. 46(R), Consolidation of Variable Interest Entities, and amends the consolidation guidance for variable interest entities under FIN No. 46(R) . SFAS 167 is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the impact of the adoption of SFAS 167 on the Company s condensed consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to market risk for changes in the market values of our investments (Investment Risk) and the impact of interest rate changes (Interest Rate Risk). We have not used derivative financial instruments in our investment portfolio. The quantitative and qualitative disclosures about market risk are set forth below.

Investment Risk

As of June 30, 2009, our total holdings in equity securities of other companies, including equity-method investments and available-for-sale securities, were $67.8 million. Of this amount, we had equity-method investments of $66.3 million and publicly traded equity securities (available-for-sale securities) at fair value totaling $1.3 million (included in marketable securities and investments and other assets).

We regularly review the carrying value of our investments and identify and recognize losses, for income statement purposes, when events and circumstances indicate that any declines in the fair values of such investments, below our accounting basis, are other than temporary.

Interest Rate Risk

Our exposure to interest rate risk relates primarily to our non-equity investment portfolio and our floating rate debt. Our cash is invested in A-rated money market mutual funds.

Our portfolio of marketable securities include U.S. Treasury and agency securities classified as available-for-sale securities, with no security having a maturity in excess of two years. These securities are exposed to interest rate fluctuations. Because of the short-term nature of these investments, we are subject to minimal interest rate risk and do not believe an increase in market rates would have a significant negative impact on the realized value of our portfolio.

Based on quoted market rates of interest and maturity schedules for similar debt issues, we estimate that the fair values of our 2006 Credit Facility and our other notes payable approximated their carrying values on June 30, 2009. As of June 30, 2009, the fair value of our CODES was $7.0 million less than the carrying value. While changes in market interest rates may affect the fair value of our fixed-rate debt, we believe the effect, if any, of reasonably possible near-term changes in the fair value of such debt on our financial condition, results of operations or cash flows will not be material.

At this time, we have no material foreign exchange or commodity price risks.

We do not believe that inflation has had a significant impact on our revenues or operations.

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ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company s Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission s (SEC s) rules and forms, and that such information is accumulated and communicated to the Company s management, including its Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, the Company has investments in certain unconsolidated entities. As the Company does not control or manage these entities, its disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those it maintains with respect to its consolidated subsidiaries.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of the end of the quarter covered by this Quarterly Report. Based on the foregoing, the Company s Principal Executive Officer and Principal Financial Officer concluded that the Company s disclosure controls and procedures were effective.

There have been no changes in the Company s internal control over financial reporting, during the three months ended June 30, 2009, that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For information regarding legal proceedings, refer to PART I, ITEM 3. LEGAL PROCEEDINGS, of our Annual Report on Form 10-K for the year ended December 31, 2008 and *Legal Matters* in NOTE 10 CONTINGENCIES in the accompanying Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

ITEM 1A. RISK FACTORS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Any statements made in this report that are not statements of historical fact or that refer to estimated or anticipated future events are forward-looking statements. We have based our forward-looking statements on management s beliefs and assumptions based on information available to our management at the time these statements are made. Such forward-looking statements reflect our current perspective of our business, future performance, existing trends and information as of the date of this filing. These include, but are not limited to, our beliefs about future revenue and expense levels and growth rates, prospects related to our strategic initiatives and business strategies, including the integration of, and synergies associated with, strategic acquisitions, express or implied assumptions about government regulatory action or inaction, anticipated product approvals and launches, business initiatives and product development activities, assessments related to clinical trial results, product performance and competitive environment, and anticipated financial performance. Without limiting the generality of the foregoing, words such as *may, will, expect, believe, anticipate, intend, could, would, estimate, continue, or pursue,* or the negative or other variations thereof or comparable terminology, are intended to identify forward-looking statements. The statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. We caution the reader that these statements are based on certain assumptions, risks and uncertainties, many of which are beyond our control. In addition, certain important factors may affect our actual operating results and could cause such results to differ materially from those expressed or implied by forward-looking statements. We believe the risks and uncertainties discussed under the section entitled Risks Related to Our Business, and other risks and uncertainties detailed herein and from time to time in our SEC filings, may cause our actual results to vary materially than those anticipated in any forward-looking statement.

We disclaim any obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

Risks Related to Our Business

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. The following discussion highlights some of these risks and others are discussed elsewhere in this quarterly report. These and other risks could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Risks Associated With Investing In the Business of Watson

Our operating results and financial condition may fluctuate.

Our operating results and financial condition may fluctuate from quarter to quarter and year to year for a number of reasons. The following events or occurrences, among others, could cause fluctuations in our financial performance from period to period:

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development of new competitive products or generics by others;

the timing and receipt of approvals by U.S. Food and Drug Administration (FDA) and other regulatory authorities;

the failure to obtain, delay in obtaining or restrictions or limitation on approvals from the FDA or other foreign regulatory authorities;

difficulties or delays in resolving FDA-observed deficiencies at our manufacturing facilities, which could delay our ability to obtain approvals of pending FDA product applications;

delays or failures in clinical trials that affect our ability to achieve FDA approvals or approvals from other foreign regulatory authorities;

serious or unexpected health or safety concerns with our products or product candidates;

changes in the amount we spend to develop, acquire or license new products, technologies or businesses;

changes in the amount we spend to promote our products;

delays between our expenditures to acquire new products, technologies or businesses and the generation of revenues from those acquired products, technologies or businesses;

changes in treatment practices of physicians that currently prescribe our products;

changes in coverage and reimbursement policies of health plans and other health insurers, including changes that affect newly developed or newly acquired products;

changes in laws and regulations concerning coverage and reimbursement of pharmaceutical products, including changes to Medicare, Medicaid, and other healthcare similar state programs;

increases in the cost of raw materials used to manufacture our products;

manufacturing and supply interruptions, including failure to comply with manufacturing specifications;

the effect of economic changes in hurricane and other natural disaster-affected areas;

the impact of third party patents and other intellectual property rights which we may be found to infringe, or may be required to license, and the potential damages or other costs we may be required to pay as a result of a finding that we infringe such intellectual property rights or a decision that we are required to obtain a license to such intellectual property rights;

the mix of products that we sell during any time period;

lower than expected demand for our products;

our responses to price competition;

our ability to successfully integrate and commercialize the products, technologies and businesses we acquire or license, as applicable;

expenditures as a result of legal actions;

market acceptance of our products;

the impairment and write-down of goodwill or other intangible assets;

disposition of our primary products, technologies and other rights;

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termination or expiration of, or the outcome of disputes relating to, trademarks, patents, license agreements and other rights;

changes in insurance rates for existing products and the cost of insurance for new products;

general economic and industry conditions, including changes in interest rates affecting returns on cash balances and investments that affect customer demand;

our level of R&D activities;

impairment or write-down of investments;

costs and outcomes of any tax audits or any litigation involving intellectual property, customers or other issues; and

timing of revenue recognition related to licensing agreements and/or strategic collaborations.

As a result, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful, and these comparisons should not be relied upon as an indication of future performance. The above factors may cause our operating results to fluctuate and adversely affect our financial condition and results of operations.

If we are unable to successfully develop or commercialize new products, our operating results will suffer.

Our future results of operations will depend to a significant extent upon our ability to successfully develop and commercialize new brand and generic products in a timely manner. There are numerous difficulties in developing and commercializing new products, including:

developing, testing and manufacturing products in compliance with regulatory standards in a timely manner;

failure to receive requisite regulatory approvals for such products in a timely manner or at all;

the availability, on commercially reasonable terms, of raw materials, including API and other key ingredients;

developing and commercializing a new product is time consuming, costly and subject to numerous factors, including legal actions brought by our competitors, that may delay or prevent the development and commercialization of new products;

experiencing delays or unanticipated costs; and

commercializing generic products may be substantially delayed by the listing with the FDA of patents that have the effect of potentially delaying approval of the off-patent product by up to 30 months.

As a result of these and other difficulties, products currently in development by us may or may not receive timely regulatory approvals, or approvals at all, necessary for marketing by us or other third-party partners. This risk particularly exists with respect to the development of proprietary products because of the uncertainties, higher costs and lengthy time frames associated with research and development of such products and the inherent unproven market acceptance of such products. Additionally, we face heightened risks in connection with our development of extended release or controlled release generic products because of the technical difficulties and regulatory requirements related to such products. If any of our products are not timely approved or, when

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acquired or developed and approved, cannot be successfully or timely commercialized, our operating results could be adversely affected. We cannot guarantee that any investment we make in developing products will be recouped, even if we are successful in commercializing those products.

Our brand pharmaceutical expenditures may not result in commercially successful products.

Developing and commercializing brand pharmaceutical products is generally more costly than generic products. In the future, we anticipate continuing our product development expenditures for our Brand business segment. For example in November 2008, the FDA accepted for filing a New Drug Application (NDA) for a six month formulation of our Trelstar® (triptorelin for injection) product for prostate cancer and its review is ongoing. We cannot be sure these or other business expenditures will result in the successful discovery, development or launch of brand products that will prove to be commercially successful or will improve the long-term profitability of our business. If such business expenditures do not result in successful discovery, development or launch of commercially successful brand products our results of operations and financial condition could be materially adversely affected.

Loss of revenues from Ferrlecit®, a significant product, could have a material adverse effect on our results of operations, financial condition and cash flows.

In 2008, Ferrlecit® accounted for approximately 12% of our gross profit. We lost regulatory exclusivity on our Ferrlecit® product in 2004 and, as a result generic applicants became eligible to submit Abbreviated New Drug Applications (ANDAs) for Ferrlecit®. In 2004 we submitted Citizen Petitions to the FDA requesting that the FDA not approve any ANDA for a generic version of Ferrlecit® until certain manufacturing, physiochemical and safety and efficacy criteria are satisfied, and requesting that the FDA refuse to accept for substantive review any ANDA referencing Ferrlecit® until the FDA establishes guidelines for determining whether the generic product is the same complex as Ferrlecit®. Additionally, in October 2006, we submitted a supplement to our Citizen Petition, reiterating our request for the FDA to establish guidelines for determining what data are needed to prove that generic formulations of Ferrlecit® contain the same active complex as Ferrlecit®. However, we cannot predict whether the FDA will grant or deny our Citizen Petitions or when it may take such action. Accordingly, it is possible that Ferrlecit could face generic competition before our distribution rights expire at the end of 2009.

In July 2009 we entered into an exclusive license and marketing agreement with Generamedix, Inc. for a generic version of Ferrlecit® . Generamedix currently has an abbreviated new drug application pending with the FDA. Like Ferrlecit® , a generic version of Ferrlecit® could face competition from other generic versions of Ferrlecit® or similar competing products. We cannot predict whether the FDA will approve Generamedix s pending application or, if approved, whether we will be able to successfully commercialize it.

In addition to risks associated with generic competition, we are aware of competitors that are developing or have developed proprietary products that could compete with Ferrlecit®. These products may be considered safer or more efficacious, or could be less costly than Ferrlecit®.

If a generic version of Ferrlecit® or other competitive product is approved by the FDA and enters the market during 2009, our net revenues and profits could significantly decline, which could have a material adverse effect on our results of operations, financial condition and cash flows.

A large percentage of our Ferrlecit® sales are made to dialysis centers. In recent years, there has been significant consolidation of the dialysis business, marked by mergers and acquisitions among dialysis centers. As a result, a small number of customers control a significant share of the injectable iron market in which Ferrlecit® competes. Continued consolidation may adversely impact pricing and create other competitive pressures on suppliers of injectable iron.

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During 2008, our largest customer for Ferrlecit® accounted for approximately 37% of our Ferrlecit® sales. During 2008 that customer became the exclusive U.S. licensee of Venofer, a product that directly competes with Ferrlecit®. If we are not able to maintain our Ferrlecit business with our largest customer until the end of 2009, or if we lose any other significant Ferrlecit® customer, our business, results of operations, financial condition and cash flows could be materially adversely affected.

Any acquisitions of technologies, products and businesses, may be difficult to integrate, could adversely affect our relationships with key customers, and/or could result in significant charges to earnings.

We regularly review potential acquisitions of technologies, products and businesses complementary to our business. Acquisitions typically entail many risks and could result in difficulties in integrating operations, personnel, technologies and products. If we are not able to successfully integrate our acquisitions, we may not obtain the advantages and synergies that the acquisitions were intended to create, which may have a material adverse effect on our business, results of operations, financial condition and cash flows, our ability to develop and introduce new products and the market price of our stock. In addition, in connection with acquisitions, we could experience disruption in our business, technology and information systems, customer or employee base, including diversion of management s attention from our continuing operations. There is also a risk that key employees of companies that we acquire or key employees necessary to successfully commercialize technologies and products that we acquire may seek employment elsewhere, including with our competitors. Furthermore, there may be overlap between our products or customers and the companies that we acquire that may create conflicts in relationships or other commitments detrimental to the integrated businesses. For example, in our Distribution business, our main competitors are McKesson Corporation, AmerisourceBergen Corporation and Cardinal Health, Inc. These companies are significant customers of our Generic and Brand operations and who collectively accounted for approximately 28% of our annual net revenues in 2008. Our activities related to our Distribution business, as well as the acquisition of other businesses that compete with our customers, may result in the disruption of our business, which could harm relationships with our current customers, employees or suppliers, and could adversely affect our expenses, pricing, third-party relationships and revenues.

In addition, as a result of acquiring businesses or products, or entering into other significant transactions, we have experienced, and will likely continue to experience, significant charges to earnings for merger and related expenses. These costs may include substantial fees for investment bankers, attorneys, accountants and financial printing costs and severance and other closure costs associated with the elimination of duplicate or discontinued products, operations and facilities. Charges that we may incur in connection with acquisitions could adversely affect our results of operations for particular quarterly or annual periods.

If we are unsuccessful in our joint ventures and other collaborations, our operating results could suffer.

We have made substantial investments in joint ventures and other collaborations and may use these and other methods to develop or commercialize products in the future. These arrangements typically involve other pharmaceutical companies as partners that may be competitors of ours in certain markets. In many instances, we will not control these joint ventures or collaborations or the commercial exploitation of the licensed products, and cannot assure you that these ventures will be profitable. Although restrictions contained in certain of these programs have not had a material adverse impact on the marketing of our own products to date, any such marketing restrictions could affect future revenues and have a material adverse effect on our operations. Our results of operations may suffer if existing joint venture or collaboration partners withdraw, or if these products are not timely developed, approved or successfully commercialized.

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If we are unable to adequately protect our technology or enforce our patents, our business could suffer.

Our success with the brand products that we develop will depend, in part, on our ability to obtain patent protection for these products. We currently have a number of U.S. and foreign patents issued and pending**,** and upon the Arrow Acquisition, our patent portfolio will extend to several additional foreign jurisdictions. However, issuance of a patent is not conclusive evidence of its validity or enforceability. We cannot be sure that we will receive patents for any of our pending patent applications or any patent applications we may file in the future, or that our issued patents will be upheld if challenged. For example, in September, 2008, we received notice that Duramed Pharmaceuticals had filed an ANDA seeking to market a generic version of our Oxytrol product, and contending that our patents covering Oxytrol are invalid or not infringed. If our current and future patent applications are not approved or, if approved, our patents are not upheld in a court of law if challenged, it may reduce our ability to competitively exploit our patented products. Also, such patents may or may not provide competitive advantages for their respective products or they may be challenged or circumvented by our competitors, in which case our ability to commercially market these products may be diminished.

We also rely on trade secrets and proprietary know-how that we seek to protect, in part, through confidentiality agreements with our partners, customers, employees and consultants. It is possible that these agreements will be breached or that they will not be enforceable in every instance, and that we will not have adequate remedies for any such breach. It is also possible that our trade secrets will become known or independently developed by our competitors.

If we are unable to adequately protect our technology, trade secrets or propriety know-how, or enforce our patents, our results of operations, financial condition and cash flows could suffer.

If pharmaceutical companies are successful in limiting the use of generics through their legislative, regulatory and other efforts, our sales of generic products may suffer.

Many pharmaceutical companies increasingly have used state and federal legislative and regulatory means to delay generic competition. These efforts have included:

- pursuing new patents for existing products which may be granted just before the expiration of one patent, which could extend patent protection for additional years or otherwise delay the launch of generics;
- selling the brand product as an Authorized Generic, either by the brand company directly, through an affiliate or by a marketing partner;
- using the Citizen Petition process to request amendments to FDA standards;
- seeking changes to U.S. Pharmacopeia, an organization which publishes industry recognized compendia of drug standards;
- attaching patent extension amendments to non-related federal legislation;
- engaging in state-by-state initiatives to enact legislation that restricts the substitution of some generic drugs, which could have an impact on products that we are developing; and
- seeking patents on methods of manufacturing certain API.

If pharmaceutical companies or other third parties are successful in limiting the use of generic products through these or other means, our sales of generic products may decline. If we experience a material decline in generic product sales, our results of operations, financial condition and cash flows will suffer.

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If competitors are successful in limiting competition for certain generic products through their legislative, regulatory and litigation efforts, our sales of certain generic products may suffer.

Certain of our competitors have recently challenged our ability to distribute Authorized Generics during the competitors 180-day period of ANDA exclusivity under the Hatch-Waxman Act. Under the challenged arrangements, we have obtained rights to market and distribute under a brand manufacturer s NDA a generic alternative of the brand product. Some of our competitors have challenged the propriety of these arrangements by filing Citizen Petitions with the FDA, initiating lawsuits alleging violation of the antitrust and consumer protection laws, and seeking legislative intervention. The FDA and courts that have considered the subject to date have ruled that there is no prohibition in the Federal Food, Drug, and Cosmetic Act against distributing Authorized Generic versions of a brand drug. However, on February 3, 2009, legislation was introduced in the U.S. Senate that would prohibit the marketing of Authorized Generics during the 180-day period of ANDA exclusivity under the Hatch-Waxman Act. Further, the Deficit Reduction Act of 2005 (DRA) added provisions to the Medicaid Rebate Program that, effective January 1, 2007, may have the effect of increasing an NDA holder s Medicaid Rebate liability if it permits another manufacturer to market an Authorized Generic version of its brand product. This may affect the willingness of brand manufacturers to continue arrangements, or enter into future arrangements, permitting us to market Authorized Generic versions of their brand products. If so, or if distribution of Authorized Generic versions of brand products is otherwise restricted or found unlawful, our results of operations, financial condition and cash flows could be materially adversely affected.

From time to time we may need to rely on licenses to proprietary technologies, which may be difficult or expensive to obtain.

We may need to obtain licenses to patents and other proprietary rights held by third parties to develop, manufacture and market products. If we are unable to timely obtain these licenses on commercially reasonable terms, our ability to commercially market our products may be inhibited or prevented, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Third parties may claim that we infringe their proprietary rights and may prevent us from manufacturing and selling some of our products.

The manufacture, use and sale of new products that are the subject of conflicting patent rights have been the subject of substantial litigation in the pharmaceutical industry. These lawsuits relate to the validity and infringement of patents or proprietary rights of third parties. We may have to defend against charges that we violated patents or proprietary rights of third parties. This is especially true in the case of generic products on which the patent covering the brand product is expiring, an area where infringement litigation is prevalent, and in the case of new brand products where a competitor has obtained patents for similar products. Litigation may be costly and time-consuming, and could divert the attention of our management and technical personnel. In addition, if we infringe on the rights of others, we could lose our right to develop, manufacture or market products or could be required to pay monetary damages or royalties to license proprietary rights from third parties. For example, we are engaged in litigation with Duramed Pharmaceuticals concerning whether our Quasense product infringes Duramed s U.S. Patent Number RE 39,861, and we continue to manufacture and market our Quasense product during the pendency of the litigation. Although the parties to patent and intellectual property disputes in the pharmaceutical industry have often settled their disputes through licensing or similar arrangements, the costs associated with these arrangements may be substantial and could include ongoing royalties. Furthermore, we cannot be certain that the necessary licenses would be available to us on commercially reasonable terms, or at all. As a result, an adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us from manufacturing and selling a number of our products, and could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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Our distribution operations are highly dependent upon a primary courier service.

Product deliveries within our Distribution business are highly dependent on overnight delivery services to deliver our products in a timely and reliable manner, typically by overnight service. Our Distribution business ships a substantial portion of products via one courier s air and ground delivery service. If the courier terminates our contract with this courier or we cannot renew the courier s contract on favorable terms or enter into a contract with an equally reliable overnight courier to perform and offer the same service level at similar or more favorable rates, our business, results of operations, financial condition and cash flows could be materially adversely affected.

Our distribution operations concentrate on generic products and therefore are subject to the risks of the generic industry.

The ability of our Distribution business to provide consistent, sequential quarterly growth is affected, in large part, by our participation in the launch of new products by generic manufacturers and the subsequent advent and extent of competition encountered by these products. This competition can result in significant and rapid declines in pricing with a corresponding decrease in net sales of our Distribution business. Our margins can also be affected by the risks inherent to the generic industry, which are discussed below under Risks Relating To Investing In the Pharmaceutical Industry .

If we are unable to obtain sufficient supplies from key manufacturing sites or suppliers that in some cases may be the only source of finished products or raw materials, our ability to deliver our products to the market may be impeded.

We are required to identify the supplier(s) of all the raw materials for our products in our applications with the FDA. To the extent practicable, we attempt to identify more than one supplier in each drug application. However, some products and raw materials are available only from a single source and, in some of our drug applications, only one supplier of products and raw materials or site of manufacture has been identified, even in instances where multiple sources exist. Some of these products have historically accounted for a significant portion of our revenues, such as Ferrlecit®, INFed®, bupropion sustained release tablets and a significant number of our oral contraceptive products. From time to time, certain of our manufacturing sites or outside suppliers have experienced regulatory or supply-related difficulties that have inhibited their ability to deliver products and raw materials to us, causing supply delays or interruptions. To the extent any difficulties experienced by our manufacturing sites or suppliers cannot be resolved or extensions of our key supply agreements cannot be negotiated within a reasonable time and on commercially reasonable terms, or if raw materials for a particular product become unavailable from an approved supplier and we are required to qualify a new supplier with the FDA, or if we are unable to do so, our profit margins and market share for the affected product could decrease or be eliminated, as well as delay our development and sales and marketing efforts. Such outcomes could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Our manufacturing sites in India and our arrangements with foreign suppliers are subject to certain additional risks, including the availability of government clearances, export duties, political instability, war, acts of terrorism, currency fluctuations and restrictions on the transfer of funds. For example, we obtain a significant portion of our raw materials from foreign suppliers. Arrangements with international raw material suppliers are subject to, among other things, FDA regulation, customs clearances, various import duties and other government clearances, as well as potential shipping delays due to inclement weather, strikes or other matters outside of our control. Acts of governments outside the U.S. may affect the price or availability of raw materials needed for the development or manufacture of our products. In addition, recent changes in patent laws in jurisdictions outside the U.S. may make it increasingly difficult to obtain raw materials for R&D prior to the expiration of the applicable U.S. or foreign patents. Upon the consummation of the Arrow Acquisition, we will face similar risks in an increased number of foreign jurisdictions.

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Our policies regarding returns, allowances and chargebacks, and marketing programs adopted by wholesalers, may reduce our revenues in future fiscal periods.

Consistent with industry practice we, like many generic product manufacturers, have liberal return policies and have been willing to give customers post-sale inventory allowances. Under these arrangements, from time to time, we may give our customers credits on our generic products that our customers hold in inventory after we have decreased the market prices of the same generic products. Therefore, if new competitors enter the marketplace and significantly lower the prices of any of their competing products, we may reduce the price of our product. As a result, we may be obligated to provide significant credits to our customers who are then holding inventories of such products, which could reduce sales revenue and gross margin for the period the credit is provided. Like our competitors, we also give credits for chargebacks to wholesale customers that have contracts with us for their sales to hospitals, group purchasing organizations, pharmacies or other retail customers. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to us by our wholesale customer for a particular product and the negotiated contract price that the wholesaler s customer pays for that product. Although we establish reserves based on our prior experience and our best estimates of the impact that these policies may have in subsequent periods, we cannot ensure that our reserves are adequate or that actual product returns, allowances and chargebacks will not exceed our estimates, which could have a material adverse effect on our results of operations, financial condition, cash flows and the market price of our stock.

Investigations of the calculation of average wholesale prices may adversely affect our business.

Many government and third-party payers, including Medicare, Medicaid, Health Maintenance Organizations(HMOs) and Managed Care Organizations (MCOs), have historically reimbursed, or continue to reimburse, doctors and others for the purchase of certain prescription drugs based on a drug s average wholesale price (AWP). In the past several years, state and federal government agencies have conducted ongoing investigations of manufacturers reporting practices with respect to AWP, in which they have suggested that reporting of inflated AWP s have led to excessive payments for prescription drugs. For example, beginning in July 2002, we and certain of our subsidiaries, as well as numerous other pharmaceutical companies, were named as defendants in various state and federal court actions alleging improper or fraudulent practices related to the reporting of AWP of certain products, and other improper acts, in order to increase prices and market shares. Additional actions are anticipated. These actions, if successful, could adversely affect us and may have a material adverse effect on our business, results of operations, financial condition and cash flows. See *Legal Matters* in NOTE 10 CONTINGENCIES in the accompanying Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

The design, development, manufacture and sale of our products involves the risk of product liability claims by consumers and other third parties, and insurance against such potential claims is expensive and may be difficult to obtain.

The design, development, manufacture and sale of our products involve an inherent risk of product liability claims and the associated adverse publicity. Insurance coverage is expensive and may be difficult to obtain, and may not be available in the future on acceptable terms, or at all. If the coverage limits for product liability insurance policies are not adequate, a claim brought against Watson, whether covered by insurance or not, could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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The loss of our key personnel could cause our business to suffer.

The success of our present and future operations will depend, to a significant extent, upon the experience, abilities and continued services of key personnel. For example, although we have other senior management personnel, a significant loss of the services of Paul Bisaro, our Chief Executive Officer, or other senior executive officers without hiring a suitable successor, could cause our business to suffer. We cannot assure you that we will be able to attract and retain key personnel. We have entered into employment agreements with the majority of our senior executive officers but such agreements do not guarantee that our senior executive officers will remain employed by us for a significant period of time, or at all. We do not carry key-man life insurance on any of our officers.

Rising insurance costs could negatively impact profitability.

The cost of insurance, including workers compensation, product liability and general liability insurance, can increase significantly in a given period and may increase in the future. In response, we may increase deductibles and/or decrease certain lines of coverage to mitigate these costs. These increases, and our increased risk due to increased deductibles and reduced lines of coverage, could have a negative impact on our results of operations, financial condition and cash flows.

Significant balances of intangible assets, including product rights and goodwill acquired, are subject to impairment testing and may result in impairment charges, which will adversely affect our results of operations and financial condition.

A significant amount of our total assets is related to acquired intangibles and goodwill. As of June 30, 2009, the carrying value of our product rights and other intangible assets was approximately $532 million and the carrying value of our goodwill was approximately $868 million.

Our product rights are stated at cost, less accumulated amortization. We determine original fair value and amortization periods for product rights based on our assessment of various factors impacting estimated useful lives and cash flows of the acquired products. Such factors include the product s position in its life cycle, the existence or absence of like products in the market, various other competitive and regulatory issues and contractual terms. Significant adverse changes to any of these factors would require us to perform an impairment test on the affected asset and, if evidence of impairment exists, we would be required to take an impairment charge with respect to the asset. Such a charge could have a material adverse effect on our results of operations and financial condition.

Our other significant intangible assets include acquired core technology and customer relationships, which are intangible assets with definite lives, and the Anda trade name, which is an intangible asset with an indefinite life, as we intend to use the Anda trade name indefinitely.

Our acquired core technology and customer relationship intangible assets are stated at cost, less accumulated amortization. We determined the original fair value of our other intangible assets by performing a discounted cash flow analysis, which is based on our assessment of various factors. Such factors include existing operating margins, the number of existing and potential competitors, product pricing patterns, product market share analysis, product approval and launch dates, the effects of competition, customer attrition rates, consolidation within the industry and generic product lifecycle estimates. Our other intangible assets with definite lives are tested for impairment when there are significant changes to any of these factors. Our other intangible assets with indefinite lives are tested for impairment annually, or more frequently if there are significant changes to any of the above factors. If evidence of impairment exists, we would be required to take an impairment charge with respect to the impaired asset. Such a charge could have a material adverse effect on our results of operations and financial condition.

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Goodwill and our Anda trade name intangible asset are tested for impairment annually and when events occur or circumstances change that could potentially reduce the fair value of the reporting unit or intangible asset. Impairment testing compares the fair value of the reporting unit or intangible asset to its carrying amount. A goodwill or trade name impairment, if any, would be recorded in operating income and could have a material adverse effect on our results of operations and financial condition.

We may need to raise additional funds in the future which may not be available on acceptable terms or at all.

We may consider issuing additional debt or equity securities in the future to fund potential acquisitions or investments, to refinance existing debt, or for general corporate purposes. If we issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. If we incur additional debt, it may increase our leverage relative to our earnings or to our equity capitalization, requiring us to pay additional interest expenses. We may not be able to market such issuances on favorable terms, or at all, in which case, we may not be able to develop or enhance our products, execute our business plan, take advantage of future opportunities, or respond to competitive pressures or unanticipated customer requirements.

Our business could suffer as a result of manufacturing difficulties or delays.

The manufacture of certain of our products and product candidates, particularly our controlled-release products, transdermal products, and our oral contraceptive products, are more difficult than the manufacture of immediate-release products. Successful manufacturing of these types of products requires precise manufacturing process controls, API that conforms to very tight tolerances for specific characteristics and equipment that operates consistently within narrow performance ranges. Manufacturing complexity, testing requirements, and safety and security processes combine to increase the overall difficulty of manufacturing these products and resolving manufacturing problems that we may encounter.

Our manufacturing and other processes utilize sophisticated equipment, which sometimes require a significant amount of time to obtain and install. Our business could suffer if certain manufacturing or other equipment, or a portion or all of our facilities were to become inoperable for a period of time. This could occur for various reasons, including catastrophic events such as earthquake, hurricane or explosion, unexpected equipment failures or delays in obtaining components or replacements thereof, as well as construction delays or defects and other events, both within and outside of our control. Our inability to timely manufacture any of our significant products could have a material adverse effect on our results of operations, financial condition and cash flows.

Our business will continue to expose us to risks of environmental liabilities.

Our product and API development programs, manufacturing processes and distribution logistics involve the controlled use of hazardous materials, chemicals and toxic compounds in our owned and leased facilities. As a result, we are subject to numerous and increasingly stringent federal, state and local environmental laws and regulations concerning, among other things, the generation, handling, storage, transportation, treatment and disposal of toxic and hazardous materials and the discharge of pollutants into the air and water. Our programs and processes expose us to risks that an accidental contamination could result in (i) our noncompliance with such environmental laws and regulations and (ii) regulatory enforcement actions or claims for personal injury and property damage against us. If an accident or environmental discharge occurs, or if we discover contamination caused by prior operations, including by prior owners and operators of properties we acquire, we could be liable for cleanup obligations, damages and fines. The substantial unexpected costs we may incur could have a material and adverse effect on our business, results of operations, financial condition, and cash flows. In addition, environmental permits and controls are required for some of our operations, and these permits are subject to modification, renewal and revocation by the issuing authorities. Any modification, revocation or non-renewal of our environmental permits could have a material adverse effect on our ongoing operations, business and financial condition. Our environmental capital expenditures and costs for environmental compliance may increase in the

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future as a result of changes in environmental laws and regulations or increased development or manufacturing activities at any of our facilities.

Global Economic Conditions Could Harm Us.

Recent global market and economic conditions have been unprecedented and challenging with tighter credit conditions and recession in most major economies continuing into 2009. Continued concerns about the systemic impact of potential long-term and wide-spread recession, energy costs, geopolitical issues, the availability and cost of credit, and the global housing and mortgage markets have contributed to increased market volatility and diminished expectations for western and emerging economies. In the second half of 2008, added concerns fueled by the U.S. government conservatorship of the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, the declared bankruptcy of Lehman Brothers Holdings Inc., the U.S. government financial assistance to American International Group Inc., Citibank, Bank of America and other federal government interventions in the U.S. financial system lead to increased market uncertainty and instability in both U.S. and international capital and credit markets. These conditions, combined with volatile oil prices, declining business and consumer confidence and increased unemployment, have contributed to volatility of unprecedented levels.

As a result of these market conditions, the cost and availability of credit has been and may continue to be adversely affected by illiquid credit markets and wider credit spreads. Concern about the stability of the markets generally and the strength of counterparties specifically has led many lenders and institutional investors to reduce, and in some cases, cease to provide credit to businesses and consumers. These factors have lead to a decrease in spending by businesses and consumers alike, and a corresponding decrease in global infrastructure spending. Continued turbulence in the U.S. and international markets and economies and prolonged declines in business consumer spending may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our customers, including our ability to refinance maturing liabilities and access the capital markets to meet liquidity needs.

Risks Relating To Investing In the Pharmaceutical Industry

Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development, manufacturing and distribution capabilities.

All pharmaceutical companies, including Watson, are subject to extensive, complex, costly and evolving regulation by the federal government, principally the FDA and to a lesser extent by the U.S. Drug Enforcement Administration (DEA) and state government agencies, as well as by varying regulatory agencies in foreign countries where products or product candidates are being manufactured and/or marketed. The Federal Food, Drug and Cosmetic Act, the Controlled Substances Act and other federal statutes and regulations govern or influence the testing, manufacturing, packing, labeling, storing, record keeping, safety, approval, advertising, promotion, sale and distribution of our products.

Under these regulations, we are subject to periodic inspection of our facilities, procedures and operations and/or the testing of our products by the FDA, the DEA and other authorities, which conduct periodic inspections to confirm that we are in compliance with all applicable regulations. In addition, the FDA conducts pre-approval and post-approval reviews and plant inspections to determine whether our systems and processes are in compliance with current Good Manufacturing Practices (cGMP) and other FDA regulations. Following such inspections, the FDA may issue notices on Form 483 and Warning Letters that could cause us to modify certain activities identified during the inspection. A Form 483 notice is generally issued at the conclusion of a FDA inspection and lists conditions the FDA inspectors believe may violate cGMP or other FDA regulations. FDA guidelines specify that a Warning Letter is issued only for violations of regulatory significance for which the failure to adequately and promptly achieve correction may be expected to result in an enforcement action. We are also required to report adverse events associated with our products to FDA and other regulatory authorities. Unexpected or serious health or safety concerns would result in labeling changes, recalls, market withdrawals or other regulatory actions.

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Our manufacturing facility in Corona, California (which manufactured products representing approximately 12% of our total product net revenues for 2008) is currently subject to a consent decree of permanent injunction. We cannot assure that the FDA will determine we have adequately corrected deficiencies at our Corona manufacturing site, that subsequent FDA inspections at any of our manufacturing sites will not result in additional inspectional observations at such sites, that approval of any of the pending or subsequently submitted NDAs, ANDAs or supplements to such applications by Watson or our subsidiaries will be granted or that the FDA will not seek to impose additional sanctions against Watson or any of its subsidiaries. The range of possible sanctions includes, among others, FDA issuance of adverse publicity, product recalls or seizures, fines, total or partial suspension of production and/or distribution, suspension of the FDA s review of product applications, enforcement actions, injunctions, and civil or criminal prosecution. Any such sanctions, if imposed, could have a material adverse effect on our business, operating results, financial condition and cash flows. Under certain circumstances, the FDA also has the authority to revoke previously granted drug approvals. Similar sanctions as detailed above may be available to the FDA under a consent decree, depending upon the actual terms of such decree. Although we have instituted internal compliance programs, if these programs do not meet regulatory agency standards or if compliance is deemed deficient in any significant way, it could materially harm our business. Certain of our vendors are subject to similar regulation and periodic inspections.

The process for obtaining governmental approval to manufacture and market pharmaceutical products is rigorous, time-consuming and costly, and we cannot predict the extent to which we may be affected by legislative and regulatory developments. We are dependent on receiving FDA and other governmental or third-party approvals prior to manufacturing, marketing and shipping our products. Consequently, there is always the chance that we will not obtain FDA or other necessary approvals, or that the rate, timing and cost of obtaining such approvals, will adversely affect our product introduction plans or results of operations. We carry inventories of certain product(s) in anticipation of launch, and if such product(s) are not subsequently launched, we may be required to write off the related inventory.

Our Distribution operations and our customers are subject to various regulatory requirements, including requirements from the DEA, FDA, state boards of pharmacy and city and county health regulators, among others. These include licensing, registration, recordkeeping, security and reporting requirements. Although physicians may prescribe FDA approved products for an off label indication, we are permitted to market our products only for the indications for which they have been approved. Some of our products are prescribed off label and FDA or other regulatory authorities could take enforcement actions if they conclude that we or our distributors have engaged in off label marketing. In addition, several states and the federal government have begun to enforce anti-counterfeit drug pedigree laws which require the tracking of all transactions involving prescription drugs beginning with the manufacturer, through the supply chain, and down to the pharmacy or other health care provider dispensing or administering prescription drug products. For example, effective July 1, 2006, the Florida Department of Health began enforcement of the drug pedigree requirements for distribution of prescription drugs in the State of Florida. Pursuant to Florida law and regulations, wholesalers and distributors, including our subsidiary, Anda Pharmaceuticals, are required to maintain records documenting the chain of custody of prescription drug products they distribute beginning with the purchase of products from the manufacturer. These entities are required to provide documentation of the prior transaction(s) to their customers in Florida, including pharmacies and other health care entities. Several other states have proposed or enacted legislation to implement similar or more stringent drug pedigree requirements. In addition, federal law requires that a non-authorized distributor of record must provide a drug pedigree documenting the prior purchase of a prescription drug from the manufacturer or from an authorized distributor of record. In cases where the wholesaler or distributor selling the drug product is not deemed an authorized distributor of record it would need to maintain such records. FDA had announced its intent to impose additional drug pedigree requirements (e.g., tracking of lot numbers and documentation of all transactions) through implementation of drug pedigree regulations which were to have taken effect on December 1, 2006. However, a federal appeals court has issued a preliminary injunction to several wholesale distributors granting an indefinite stay of these regulations pending a challenge to the regulations by these wholesale distributors.

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Federal regulation of arrangements between manufacturers of brand and generic products could adversely affect our business.

As part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the MMA), companies are required to file with the U.S. Federal Trade Commission (FTC) and the Department of Justice certain types of agreements entered into between brand and generic pharmaceutical companies related to the manufacture, marketing and sale of generic versions of brand drugs. This requirement could affect the manner in which generic drug manufacturers resolve intellectual property litigation and other disputes with brand pharmaceutical companies and could result generally in an increase in private-party litigation against pharmaceutical companies or additional investigations or proceedings by the FTC or other governmental authorities. The impact of this requirement, and the potential private-party lawsuits associated with arrangements between brand name and generic drug manufacturers, is uncertain and could adversely affect our business. For example, in January 2009 the FTC and the State of California filed a lawsuit against us alleging that our settlement with Solvay related to our ANDA for a generic version of Androgel® is unlawful. From February through June 2009 numerous private parties purporting to represent various classes of plaintiffs filed similar lawsuits. Additionally, we have received requests for information, in the form of civil investigative demands or subpoenas, from the FTC, and are subject to ongoing FTC investigations, concerning our settlement with Cephalon related to our ANDA for a generic version of Provigil®, and our agreement with Sandoz, Inc. to relinquish our Hatch-Waxman marketing exclusivity on our ANDA for a 50 mg. generic version of Toprol XL®. Any adverse outcome of these actions or investigations, or actions or investigations related to other settlements we have entered into, could have a material adverse effect on our business, results of operations, financial condition and cash flows.

We are subject to federal and state healthcare fraud and abuse laws which may adversely affect our business.

Most of our products are reimbursed under federal and state health care programs such as Medicaid, Medicare, TriCare, and/or state pharmaceutical assistance programs. Federal and state laws designed to prevent fraud and abuse under these programs prohibit pharmaceutical companies from offering valuable items or services to customers or potential customers to induce them to buy, prescribe, or recommend Watson s products (the so-called antikickback laws). Exceptions are provided for discounts and certain other arrangements if specified requirements are met. Other federal and state laws not only prohibit us from submitting any false information to government reimbursement programs but also prohibit Watson employees from doing anything to cause, assist, or encourage Watson s customers to submit false claims for payment to these programs. Violations of the fraud and abuse laws may result in severe penalties against the responsible employees and Watson, including jail sentences, large fines, and the exclusion of Watson products from reimbursement under federal and state programs. Watson is committed to conducting the sales and marketing of its products in compliance with the healthcare fraud and abuse laws, but certain applicable laws may impose liability even in the absence of specific intent to defraud. Furthermore, should there be an ambiguity with regard to how to interpret a particular law, and even in the absence of such ambiguity, a governmental authority may take a position contrary to a position we have taken, and may impose civil and/or criminal sanctions. Any such penalties or sanctions could adversely affect us and may have a material adverse effect on our business, results of operations, financial condition and cash flows.

Healthcare reform and a reduction in the coverage and reimbursement levels by governmental authorities, HMOs, MCOs or other third-party payers may adversely affect our business.

Demand for our products depends in part on the extent to which coverage and reimbursement is available from third-party payers, such as the Medicare and Medicaid programs and private payors. In order to commercialize our products, we have obtained from government authorities and private health insurers and other organizations, such as HMOs and MCOs, recognition for coverage and reimbursement at varying levels for the cost of certain of our products and related treatments. Third-party payers increasingly challenge pricing of pharmaceutical products. Further, the trend toward managed healthcare in the U.S., the growth of organizations such as HMOs and MCOs and legislative proposals to reform healthcare and government insurance programs create uncertainties regarding the future levels of coverage and reimbursement for pharmaceutical products. Such cost containment measures and healthcare reform could reduce reimbursement of our pharmaceutical products, resulting in lower prices and a reduction in product demand. This could affect our ability to sell our products and could have a material adverse effect

on our business, results of operations, financial condition and cash flows.

Additionally, there is uncertainty surrounding the implementation of recent legislation involving payments for pharmaceuticals under government programs such as Medicare, Medicaid and Tricare, and the possibility that additional measures will be implemented through healthcare reform. Depending on how existing provisions are implemented, including, for example, those amending the methodology for certain payment rates and other computations under the Medicaid Drug Rebate program, or whether reform measures are adopted, reimbursement may be reduced or not be available for some of Watson s products. Additionally, any reimbursement granted may not be maintained or limits on reimbursement available from third-party payers may reduce the demand for, or negatively affect the price of, those products and could have a material adverse effect on our business, results of operations, financial condition and cash flows. We may also be subject to audits, investigations or lawsuits relating to reimbursement programs that could be costly to defend, divert management s attention and adversely affect our operating results.

The pharmaceutical industry is highly competitive.

We face strong competition in both our Generic and Brand product businesses. The intensely competitive environment requires an ongoing, extensive search for technological innovations and the ability to market products effectively, including the ability to communicate the effectiveness, safety and value of brand products to healthcare professionals in private practice, group practices and MCOs. Our competitors vary depending upon product categories, and within each product category, upon dosage strengths and drug-delivery systems. Based on total assets, annual revenues, and market capitalization, we are smaller than certain of our national and international competitors in the brand product arena. Most of our competitors have been in business for a longer period of time than Watson, have a greater number of products on the market and have greater financial and other resources than we do. Furthermore, recent trends in this industry are toward further market consolidation of large

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drug companies into a smaller number of very large entities, further concentrating financial, technical and market strength and increasing competitive pressure in the industry. If we directly compete with them for the same markets and/or products, their financial strength could prevent us from capturing a profitable share of those markets. It is possible that developments by our competitors will make our products or technologies noncompetitive or obsolete.

Revenues and gross profit derived from the sales of generic pharmaceutical products tend to follow a pattern based on certain regulatory and competitive factors. As patents for brand name products and related exclusivity periods expire, the first generic manufacturer to receive regulatory approval for generic equivalents of such products is generally able to achieve significant market penetration. As competing off-patent manufacturers receive regulatory approvals on similar products or as brand manufacturers launch generic versions of such products (for which no separate regulatory approval is required), market share, revenues and gross profit typically decline, in some cases dramatically. Accordingly, the level of market share, revenue and gross profit attributable to a particular generic product normally is related to the number of competitors in that product s market and the timing of that product s regulatory approval and launch, in relation to competing approvals and launches. Consequently, we must continue to develop and introduce new products in a timely and cost-effective manner to maintain our revenues and gross margins. Additionally, as new competitors enter the market, there may be increased pricing pressure on certain products, which would result in lower gross margins. This is particularly true in the case of certain Asian and other overseas competitors, who may be able to produce products at costs lower than the costs of domestic manufacturers. If we experience substantial competition from Asian or other overseas competitors with lower production costs, our profit margins will suffer.

We also face strong competition in our Distribution business, where we compete with a number of large wholesalers and other distributors of pharmaceuticals, including McKesson Corporation, AmerisourceBergen Corporation and Cardinal Health, Inc., which market both brand and generic pharmaceutical products to their customers. These companies are significant customers of our pharmaceutical business. As generic products generally have higher gross margins for distributors, each of the large wholesalers, on an increasing basis, are offering pricing incentives on brand products if the customers purchase a large portion of their generic pharmaceutical products from the primary wholesaler. As we do not offer a full line of brand products to our customers, we are at times competitively disadvantaged and must compete with these wholesalers based upon our very competitive pricing for generic products, greater service levels and our well-established telemarketing relationships with our customers, supplemented by our electronic ordering capabilities. The large wholesalers have historically not used telemarketers to sell to their customers, but recently have begun to do so. Additionally, generic manufacturers are increasingly marketing their products directly to smaller chains and thus increasingly bypassing wholesalers and distributors. Increased competition in the generic industry as a whole may result in increased price erosion in the pursuit of market share.

Sales of our products may continue to be adversely affected by the continuing consolidation of our distribution network and the concentration of our customer base.

Our principal customers in our Brand and Generic pharmaceutical operations are wholesale drug distributors and major retail drug store chains. These customers comprise a significant part of the distribution network for pharmaceutical products in the U.S. This distribution network is continuing to undergo significant consolidation marked by mergers and acquisitions among wholesale distributors and the growth of large retail drug store chains. As a result, a small number of large wholesale distributors and large chain drug stores control a significant share of the market. We expect that consolidation of drug wholesalers and retailers will increase pricing and other competitive pressures on drug manufacturers, including Watson.

For the year ended December 31, 2008, our three largest customers accounted for 11%, 11% and 9% respectively, of our net revenues. The loss of any of these customers could have a material adverse effect on our business, results of operations, financial condition and cash flows. In addition, none of our customers are party to any long-term supply agreements with us, and thus are able to change suppliers freely should they wish to do so.

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Risks Relating To Our Acquisition of Arrow Group

If we do not successfully integrate Arrow Group into our business operations, our business will be adversely affected.

Upon the close of the Arrow Acquisition, we will need to successfully integrate the operations of Arrow Group with our business operations. Integrating the operations of Arrow Group with that of our own is a complex and time-consuming process. Prior to the Arrow Acquisition, Arrow Group operated independently, with its own business, corporate culture, locations, employees and systems. There may be substantial difficulties, costs and delays involved in any integration of the business of Arrow Group with that of our own. These may include:

distracting management from day-to-day operations;

potential incompatibility of corporate cultures;

an inability to achieve synergies as planned;

costs and delays in implementing common systems and procedures; and

increased difficulties in managing our business due to the addition of international locations.

Many of these risks are accentuated because Arrow Group s operations, employees and customers are largely located outside of the U.S. Any one or all of these factors may increase operating costs or lower anticipated financial performance. Many of these factors are also outside of our control. Achieving anticipated synergies and the potential benefits underlying our reasons for the Arrow Acquisition will depend on successful integration of the businesses. The failure to integrate the business operations of Arrow Group successfully would have a material adverse effect on our business, financial condition and results of operations.

The Arrow Acquisition may not close as anticipated.

We expect that the Arrow Acquisition will close during the second half of 2009, but it is possible that the closing of the Arrow Acquisition may not close when anticipated, if at all. The closing of the Arrow Acquisition is subject to our obtaining all relevant third-party and government consents, as well as our compliance with other requirements contained in the purchase agreement governing the Arrow Acquisition. A delay in the closing of the Arrow Acquisition or a failure to consummate such acquisition may inhibit our ability to execute our business plan, and we cannot predict the resultant impact on our stock price if the Arrow Acquisition does not close.

Upon the consummation of the Arrow Acquisition, we will be subject to a variety of additional risks that may negatively impact our operations.

Upon the consummation of the Arrow Acquisition, we will be subject to risks associated with companies operating in the various foreign jurisdictions. The additional risks we may be exposed to include but are not limited to the following:

tariffs and trade barriers;
regulations related to customs and import/export matters;
longer payment cycles;

tax issues, such as tax law changes and variations in tax laws as compared to the United States;

challenges in collecting accounts receivable;

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cultural and language differences;
employment regulations; and
crimes, strikes, riots, civil disturbances, terrorist attacks and wars.

We cannot assure you that we will be able to adequately address these additional risks. If we are unable to do so, our operations might suffer.

Arrow Group s operations may become less attractive if political and diplomatic relations between the United States and any country where Arrow Group conducts business operations deteriorates.

The relationship between the United States and the countries where Arrow Group conducts business operations may weaken over time. Changes in the state of the relations between any such country and the United States are difficult to predict and could adversely affect our future operations or cause potential target businesses to become less attractive. This could lead to a decline in our profitability. Any meaningful deterioration of the political and diplomatic relations between the United States and the relevant country could have a material adverse effect on our operations after a successful completion of a business combination.

Arrow Group s global operations will expose us to additional risks and challenges associated with conducting business internationally.

Although we currently have limited international operations, upon the consummation of the Arrow Acquisition, we will operate on a global basis with offices or activities in Europe, Africa, Asia, South America, Australia and North America. We will face several risks inherent in conducting business internationally, including compliance with international and U.S. laws and regulations that apply to our international operations. Compliance with these laws will increase our cost of doing business in foreign jurisdictions. These laws and regulations include data privacy requirements, labor relations laws, tax laws, anti-competition regulations, import and trade restrictions, export requirements, U.S. laws such as the Foreign Corrupt Practices Act, and local laws which also prohibit corrupt payments to governmental officials. Given the high level of complexity of these laws, however, there is a risk that some provisions may be inadvertently breached, for example through fraudulent or negligent behavior of individual employees, our failure to comply with certain formal documentation requirements or otherwise. Violations of these laws and regulations could result in fines, criminal sanctions against us, our officers or our employees, and prohibitions on the conduct of our business. Any such violations could include prohibitions on our ability to offer our products in one or more countries and could materially damage our reputation, our brand, our international expansion efforts, our ability to attract and retain employees, our business and our operating results. Our success depends, in part, on our ability to anticipate these risks and manage these difficulties upon the closing of the Arrow Acquisition. These factors or any combination of these factors may adversely affect our revenue or our overall financial performance.

Upon the close of the Arrow Acquisition we may have exposure to additional tax liabilities.

As a multinational corporation, we will be subject to income taxes as well as non-income based taxes, in both the United States and various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes and other tax liabilities. Changes in tax laws or tax rulings may have a significantly adverse impact on our effective tax rate. Recent proposals by the current U.S. administration for fundamental U.S. international tax reform, including without limitation provisions that would limit the ability of U.S. multinationals to defer U.S. taxes on foreign income, if enacted, could have a significant adverse impact on our effective tax rate following the Arrow Acquisition.

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Foreign currency fluctuations could adversely affect our business and financial results.

Arrow Group does business and generates sales in several countries outside the United States. As such, upon the consummation of the Arrow Acquisition, foreign currency fluctuations may affect the costs that we incur in such international operations. It is also possible that some of our operating expenses may be incurred in non-U.S. dollar currencies. The appreciation of non-U.S. dollar currencies in those countries where we have operations against the U.S. dollar would increase our costs and could harm our results of operations and financial condition.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities.

(b) Use of Proceeds

N/A.

(c) Issuer Purchases of Equity Securities

During the quarter ended June 30, 2009, the Company repurchased approximately 2,000 shares surrendered to the Company to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees for total consideration of $0.1 million as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicaly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
April 1 - 30, 2009		$		
May 1 - 31, 2009		$		
June 1 - 30, 2009	1,977	$ 33.87		

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At our Annual Meeting of Stockholders held on May 8, 2009, the following proposals were set before the stockholders for their vote:

Proposal 1. To elect three persons as Class II directors to a three-year term and until their successors are duly elected and qualified.

	Jack Michelson	Ronald R. Taylor	Andrew L. Turner
Votes *For*	88,734,397	87,771,613	88,503,714
Votes to *Withhold Authority*	1,043,331	2,006,115	1,274,014

The terms of the following directors continued after the annual meeting:

Class III	Expiration of Term
Paul M. Bisaro	2010
Michel J. Feldman	2010
Fred G. Weiss	2010
Class I	
Michael J. Fedida	2011
Albert F. Hummel	2011
Catherine M. Klema	2011

Proposal 2. To ratify of the appointment of PricewaterhouseCoopers LLP as the Company s independent auditor for the year ending December 31, 2009:

Votes *For* 87,872,712 shares
Votes *Against* 1,842,857 shares
Votes *Abstained* 62,158 shares

ITEM 6. EXHIBITS

(a) Exhibits:

Reference is hereby made to the Exhibit Index on page 60.

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SIGNATURES

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

WATSON PHARMACEUTICALS, INC.
(Registrant)

By: **/s/ R. Todd Joyce**
R. Todd Joyce
Vice President Corporate Controller and Treasurer (Principal Accounting Officer and Acting Principal Financial Officer)

Date: July 31, 2009

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WATSON PHARMACEUTICALS, INC.
EXHIBIT INDEX TO FORM 10-Q
For the Quarterly Period Ended June 30, 2009

Exhibit No.	Description
10.1	Amendment No. 1, dated July 1, 2009, to the Credit Agreement dated November 3, 2006, by and among Watson Pharmaceuticals, Inc., Canadian Imperial Bank of Commerce, acting through its New York agency, as administrative agent, Wachovia Capital Markets, LLC, as syndication agent, a syndicate of lenders, and Wells Fargo Bank, National Association, Union Bank of California, N.A., Sumitomo Mitsui Banking Corporation, as documentation agents and the financial institutions from time to time party thereto.
31.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14a of the Securities Exchange Act of 1934.
31.2	Certification of Acting Principal Financial Officer pursuant to Rule 13a-14a of the Securities Exchange Act of 1934.
32.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14(d) of the Securities Exchange Act of 1934.
32.2	Certification of Acting Principal Financial Officer pursuant to Rule 13a-14(d) of the Securities Exchange Act of 1934.