KING PHARMACEUTICALS INC
Form 10-Q
November 14, 2001

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

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NO. 0-24425

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

TENNESSEE	54-1684963
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
501 FIFTH STREET, BRISTOL TN	37620
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (423) 989-8000

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 [X] No [ ]

Number of shares outstanding of Registrant's common stock as of November 12, 2001: 245,632,409

PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
	(UNAUDITED)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 19,986	$ 76,395
Accounts receivable, net of allowance for doubtful accounts of $6,200 and $5,000	131,533	120,702
Inventories	96,972	65,089
Deferred income taxes	16,862	26,733
Prepaid expenses and other current assets	6,005	28,324
Total current assets	271,358	317,243
Property, plant and equipment, net	138,977	128,521
Intangible assets, net	1,047,965	790,324
Other assets	65,813	46,307
Total assets	$1,524,113	$1,282,395
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 17,104	$ 25,010
Accrued expenses	107,218	78,545
Income taxes payable	39,189	--
Current portion of long-term debt	1,509	1,527
Total current liabilities	165,020	105,082
Long-term debt:		
Senior Subordinated Notes	96,382	96,382
Other	2,257	2,623
Deferred income taxes	17,074	16,989
Other liabilities	66,327	73,586
Total liabilities	347,060	294,662
Commitments and contingencies (notes 5 and 6)		
Shareholders' equity	1,177,053	987,733
Total liabilities and shareholders' equity	$1,524,113	$1,282,395

See accompanying notes.

KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS SEPTEMBER	
	2001	2000(1)	2001	20
Revenues:				
Net sales	$218,481	$156,323	$581,887	$4
Royalty revenue	11,608	9,219	36,028	
Total revenues	230,089	165,542	617,915	4
Operating costs and expenses:				
Cost of revenues, including royalty expense of $2,113, $2,533, $8,230 and $7,050	47,348	37,060	129,108	1
Nonrecurring charge - cost of revenues - inventory write-off	2,059	28,722	2,059	
Total cost of revenues	49,407	65,782	131,167	1
Selling, general and administrative	33,079	31,159	95,469	
Co-promotion fees	24,703	--	62,552	
Co-promotion marketing expense	3,843	--	14,302	
Depreciation and amortization	12,685	11,808	35,481	
Research and development	7,417	6,019	17,932	
Research and development - Special license rights	--	--	3,000	
Nonrecurring charge - Research and development	--	6,107	--	
Merger, restructuring, and other nonrecurring charges	3,279	42,349	3,279	
Total operating costs and expenses	134,413	163,224	363,182	3
Operating income	95,676	2,318	254,733	
Other income (expense):				
Interest income	2,164	3,105	7,743	
Interest expense	(3,358)	(9,684)	(8,949)	(
Other, net	3,558	2,285	6,502	
Total other income (expense)	2,364	(4,294)	5,296	(
Income before income taxes, extraordinary item and cumulative effect of change in accounting principle	98,040	(1,976)	260,029	
Income tax expense	(36,569)	(7,181)	(96,991)	(
Income before extraordinary item and cumulative effect of change in accounting principle	61,471	(9,157)	163,038	
Extraordinary items:				
Extinguishment of debt, net of taxes of $1,500 and $4,347, respectively	--	(2,561)	--	
Loss on disposed and impaired assets, net of taxes of $5,612	--	(9,353)	--	
Income before cumulative effect of change in accounting principle	61,471	(21,071)	163,038	
Cumulative effect of change in accounting principle, net of taxes of $325	--	--	(545)	
Net income	$ 61,471	$(21,071)	$162,493	$

Income per common share:				
Basic:				
Income before extraordinary item and cumulative effect of change in accounting principle	$ 0.27	$ (0.04)	$ 0.71	$
Extraordinary item	--	(0.06)	--	
Cumulative effect of change in accounting principle	--	--	--	
Net income	$ 0.27	$ (0.10)	$ 0.71	$
Diluted:				
Income before extraordinary item and cumulative effect of change in accounting principle	$ 0.27	$ (0.04)	$ 0.70	$
Extraordinary item	--	(0.06)	--	
Cumulative effect of change in accounting principle	--	--	--	
Net income	$ 0.27	$ (0.10)	$ 0.70	$

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(1) Restated; see Note 1 to financial statements.

See accompanying notes.

KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
AND OTHER COMPREHENSIVE INCOME
(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE DATA)

	SHARES	AMOUNT	RETAINED EARNINGS	TOTAL
Balance at December 31, 2000	170,841,178	$658,948	$328,785	$ 987,73
4 for 3 stock split (Note 10)	56,941,365	(418)	--	(41
Net income and total comprehensive income	--	--	162,493	162,49
Exercise of stock options	1,646,643	21,689	--	21,68
Effect of acceleration of vesting of stock options	--	5,556	--	5,55
Balance at September 30, 2001	229,429,186	$685,775	$491,278	$1,177,05

See accompanying notes.

KING PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Cash flows from operating activities	$250,623	$ 92,854
Cash flows from investing activities:		
Purchase of investment securities	--	(142,922)
Proceeds from maturity and sale of investment securities	--	258,020
Convertible senior note	(10,000)	--
Loans receivable	(15,000)	--
Purchases of property, plant and equipment	(20,222)	(13,116)
Purchase of intangible assets	(286,500)	(204,000)
Proceeds from sale of product rights	3,332	--
Proceeds from sale of assets	1,446	441
Net cash used in investing activities	(326,944)	(101,577)
Cash flows from financing activities:		
Proceeds from revolving credit facility	75,000	114,000
Payments on revolving credit facility	(75,000)	(159,000)
Proceeds from issuance of common shares and exercise of stock options, net	21,689	263,157
Payments of cash dividends - Jones	--	(2,619)
Payments on other long-term debt and capital lease obligations	(384)	(354,641)
Proceeds from bridge loan facility	--	25,000
Debt issuance costs	--	(850)
Other	(1,393)	--
Net cash provided by (used in) financing activities	19,912	(114,953)
Increase in cash and cash equivalents	(56,409)	(123,676)
Cash and cash equivalents, beginning of period	76,395	131,723
Cash and cash equivalents, end of period	$ 19,986	$ 8,047

See accompanying notes.

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001 AND 2000
(IN THOUSANDS)

1. GENERAL

The accompanying unaudited interim condensed consolidated financial statements of King Pharmaceuticals, Inc. (the "Company") have been prepared by the Company in accordance with the instructions to Form 10-Q and Rule 10-01 of

Regulation S-X, and accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (including items of a normal recurring nature) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. These interim statements should be read in conjunction with the financial statements and notes thereto included in the Company's latest Annual Report on Form 10-K/A. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

These consolidated financial statements include the accounts of King and its wholly owned subsidiaries, Monarch Pharmaceuticals, Inc., Parkedale Pharmaceuticals, Inc., King Pharmaceuticals Research and Development, Inc. (formerly Medco Research, Inc.), Jones Pharma Incorporated, and King Pharmaceuticals of Nevada, Inc. All intercompany transactions and balances have been eliminated in consolidation.

2000 Restatement

The Company has restated its consolidated statement of income for the three and nine months ended September 30, 2000 to reflect losses on disposed inventory as operating expense rather than as an extraordinary item. The impact of this change is as follows:

	THREE MONTHS ENDED SEPTEMBER 30, 2000		NINE MONTHS ENDED SEPTEMBER 30, 2000	
	REPORTED	RESTATED	REPORTED	RESTATED
Operating income	$ 31,040	$ 2,318	$126,962	$ 98,240
Extraordinary items	$(29,865)	$(11,914)	$(34,550)	$(16,599)
Net income	$(21,071)	$(21,071)	$ 15,160	$ 15,160

2. EARNINGS PER SHARE

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
Basic income per common share:				
Weighted average common shares	229,303	220,978	228,692	214,707
Diluted income per common share:				
Weighted average common shares	229,303	220,978	228,692	214,707
Effect of stock options	2,409	--(1)	2,463	4,868

Weighted average common shares plus assumed conversions.....	231,712	220,978	231,155	219,575

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(1) The assumed exercise of stock options has an antidilutive effect on earnings per share.

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

3. INVENTORIES

Inventory consists of the following:

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
Finished goods (including $13,823 and $6,821 of sample inventory, respectively).....	$62,539	$49,825
Work-in-process.....	9,959	6,662
Raw materials.....	24,474	8,602
	$96,972	$65,089

4. ACQUISITIONS/INTANGIBLE ASSETS

On August 8, 2001, the Company acquired three branded pharmaceutical products and a fully paid license to a fourth product from Bristol-Myers Squibb ("BMS") for $285.0 million plus approximately $1.5 million of expenses. The products acquired include BMS's rights in the United States to Corzide(R), Delestrogen(R), and Florinef(R). King acquired also a fully paid license to and trademark for Corgard(R) in the United States. The acquisition was financed with a combination of borrowings under its senior secured credit facility and cash on hand.

On June 22 and July 7, 2000, the Company acquired the sales and marketing rights, respectively, of Nordette(R), Wycillin(R), and Bicillin(R) from American Home Products Corporation ("AHP") for $200.0 million plus assumed liabilities of $3.0 million. This acquisition was financed with a draw of $10.0 million on a $50.0 million bridge loan, $25.0 million in the form of a note issued to AHP, $37.5 million of the proceeds from the sale of stock to AHP, $25.0 million received in connection with the co-promotion agreement with AHP, $90.0 million from the revolving credit facility and $12.5 million in excess cash from operations.

The following unaudited pro forma summary presents the financial information as if the acquisition of the Corzide(R), Delestrogen(R), Florinef(R), Corgard(R), Nordette(R), Wycillin(R) and Bicillin(R) product lines had occurred as of January 1, 2000. These pro forma results have been prepared for comparative purposes and do not purport to be indicative of what would have occurred had the acquisition been made on January 1, 2000, nor is it indicative

of future results.

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
Net revenues	$234,183	$186,105	$632,979	$499,481
Net income (loss) before extraordinary item	$ 62,880	$ 70	$165,734	$ 64,431
Basic income per common share	$ 0.27	$ 0.00	$ 0.72	$ 0.30
Diluted income per common share	$ 0.27	$ 0.00	$ 0.72	$ 0.29

Intangible assets consist of the following:

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
Trademarks and product rights	$1,048,190	$762,669
Patents	80,000	80,000
Goodwill	16,251	16,251
Other intangibles	8,648	8,648
	1,153,089	867,568
Less accumulated amortization	(105,124)	(77,244)
	$1,047,965	$790,324

5. MERGERS, RESTRUCTURING AND NONRECURRING CHARGES

A. Merger with Medco

On February 25, 2000, the Company completed a merger with Medco Research, Inc. ("Medco"). The Medco merger was accounted for as a pooling of interests. In connection with this transaction the Company charged to expense $20,789 of merger related costs in the first quarter of 2000. The types of costs incurred and the actual cash payments made in 2001 as well as the remaining accrued balances at September 30, 2001 are summarized below:

	ACCRUED BALANCE AT DECEMBER 31,	JANUARY 1, 2001 THROUGH SEPTEMBER 30,	ACCRUED BALANCE AT SEPTEMBER 30,

	2000	2001 PAYMENTS	2001
Transaction costs	$ 797	$ --	$797
Employee costs and other	439	439	--
Total	$1,236	$439	$797

B. Merger with Jones

On August 31, 2000, the Company completed a merger with Jones Pharma Incorporated ("Jones"). The Jones merger was accounted for as a pooling of interests. In connection with the merger with Jones, the Company incurred total merger and restructuring related costs of $35,317 for the nine months ended September 30, 2000. Additionally, during the third quarter of 2001, the Company recorded employee costs related to the integration of Jones resulting in a charge of $3.3 million. This additional integration resulted in the elimination of 43 employees. The types of costs incurred and the actual cash payments made in 2001 as well as the remaining accrued balances at September 30, 2001 are summarized below:

	ACCRUED BALANCE AT DECEMBER 31, 2000	ADDITIONAL CHARGE IN THIRD QUARTER OF 2001	ACTIVITY JANUARY 1, 2001 THROUGH SEPTEMBER 30, 2001	ACCRUED BALANCE AT SEPTEMBER 3 2001
Transaction costs	$ 620	$ --	$ 620	$ --
Employee costs, including severance and acceleration of vesting of stock options	3,707	3,279	6,986	--
Total	$4,327	$3,279	$7,606	$ --

All activity was paid in cash except for $3.9 million for the acceleration of vesting for stock options.

The following information presents certain unaudited financial data of the separate companies during the three and nine months of 2000 (through date of acquisition):

	THREE MONTHS ENDED SEPTEMBER 30, 2000	NINE MONTHS ENDED SEPTEMBER 30, 2000
Net Revenues:		

Medco (through date of acquisition).....	$ --	$ 9,169
Jones (through date of acquisition).....	32,809	130,175
Total.....	$32,809	$139,344
Net Income:		
Medco (through date of acquisition).....	$ --	$ 7,244
Jones (through date of acquisition).....	6,276	45,584
Total.....	$ 6,276	$ 52,828

C. Discontinuance of Fluogen(R) Product

On September 27, 2000, the Company received written notification from the United States Food and Drug Administration ("FDA") that it must cease manufacturing and distributing Fluogen(R), an influenza vaccine, until the Company demonstrated compliance with related FDA regulations. In addition, the notification recommended that the Company properly dispose of Fluogen(R) inventory on hand. As a result of this notification, the Company decided to permanently discontinue Fluogen(R) production and distribution. This restructuring plan resulted in the elimination of approximately 160 employees of which approximately 110 were hourly and 50 were salaried. As a result of these events, the Company recorded extraordinary losses on disposed and impaired assets of $15.0 million, before tax benefit of $5.6 million, and a nonrecurring charge of $37.3 million for the year ended December 31, 2000. A summary of the types of costs incurred in 2001 and the remaining accrued balances at September 30, 2001 are summarized below:

	ACCRUED BALANCE AT DECEMBER 31, 2000	PAYMENTS	OTHER (1)	ACCRUED BALANCE AT SEPTEMBER 30, 2001
Nonrecurring charges				
Employee costs, including severance and acceleration of vesting of stock options.....	$5,270	$4,412	$858	$ --
Contractual commitments and cleanup activities.....	1,296	288	--	1,008
Total.....	$6,566	$4,700	$858	$1,008

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(1) Includes reclassification for acceleration of vesting for stock options to shareholders' equity.

D. Discontinuance of Pallacor(TM) Research and Development Efforts

In September 2000 management decided to discontinue the research and development efforts relating to Pallacor(TM) due to its inability to out-license rights to the product and its assessment of the significance of projected research and development costs relative to the likelihood of the project's success resulting in a nonrecurring research and development charge of $6.1

million. At December 31, 2000 and September 30, 2001 the Company has $4.7 million and $0.3 million, respectively, accrued for all estimated remaining contractual commitments associated with Pallacor(TM).

6. CONTINGENCIES

Fen/Phen Litigation

Many distributors, marketers and manufacturers of anorexigenic drugs have been subject to claims relating to the use of these drugs. Generally, the lawsuits allege that the defendants (1) misled users of the products with respect to the dangers associated with them, (2) failed to adequately test the products and (3) knew or should have known about the negative effects of the drugs, and should have informed the public about the risks of such negative effects. The actions generally have been brought by individuals in their own right and have been filed in various state and federal jurisdictions throughout the United States. They seek, among other things, compensatory and punitive damages and/or court supervised medical monitoring of persons who have ingested the product. The Company is one of many defendants in more than 33 lawsuits which claim damages for personal injury arising from the Company's production of the anorexigenic drug, phentermine, under contract for GlaxoSmithKline. The Company expects to be named in additional lawsuits related to the Company's production of the anorexigenic drug under contract for GlaxoSmithKline.

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

In addition, Jones, a wholly-owned subsidiary of the Company is a defendant in more than 1,100 multi-defendant lawsuits involving the manufacture and sale of dexfenfluramine, fenfluramine and phentermine. These suits have been filed in various jurisdictions throughout the United States, and in each of these suits, Jones is one of many defendants, including manufacturers and other distributors of these drugs. Although Jones has not at any time manufactured dexfenfluramine, fenfluramine, or phentermine, Jones was a distributor of a generic phentermine product, and, after the acquisition of Abana Pharmaceuticals, was a distributor of Obenix, its branded phentermine product. The plaintiffs in these cases claim injury as a result of ingesting a combination of these weight-loss drugs and are seeking compensatory and punitive damages as well as medical care and court supervised medical monitoring. The plaintiffs claim liability based on a variety of theories including but not limited to, product liability, strict liability, negligence, breach of warranty, and misrepresentation.

Jones denies any liability incident to the distribution of Obenix or its generic phentermine product and intends to pursue all defenses available to it. Jones has tendered defense of these lawsuits to its insurance carriers for handling and they are currently defending Jones in these suits. The

manufacturers of fenfluramine and dexfenfluramine have settled many of these cases. In the event that Jones' insurance coverage is inadequate to satisfy any resulting liability, Jones will have to resume defense of these lawsuits and be responsible for the damages, if any, that are awarded against it.

While the Company cannot predict the outcome of these suits, management believes that the claims against Jones are without merit and intends to vigorously pursue all defenses available. The Company is unable to disclose an aggregate dollar amount of damages claimed. Many of the complaints are multi-party suits and do not state specific damage amounts. Rather, these claims typically state damages as may be determined by the court or similar language and state no specific amount of damages against Jones. The Company, at this time, cannot provide an aggregate dollar amount of damages claimed or a reasonable estimate of possible losses related to the lawsuits.

State of Wisconsin Investment Board

On November 30, 1999, the Company entered into an agreement of merger with Medco Research, Inc. ("Medco") pursuant to which the Company acquired Medco in an all stock, tax-free pooling of interests transaction (Note 5), which was subject to approval by the Medco shareholders. On January 5, 2000, Medco issued to its stockholders a proxy statement with respect to the proposed transaction and noticed a meeting to approve the transaction for February 10, 2000.

On January 11, 2000, the State of Wisconsin Investment Board, ("SWIB"), a Medco shareholder which held approximately 11.6% of the outstanding stock of Medco, filed suit on behalf of a proposed class of Medco shareholders in the Court of Chancery for the State of Delaware, New Castle County, against Medco and members of Medco's board of directors to enjoin the shareholder vote on the merger and the consummation of the merger. State of Wisconsin Investment Board v. Bartlett, et al., C.A. No. 17727. SWIB alleged, among other things, that the proxy materials filed by Medco failed to disclose all material information and included misleading statements regarding the transaction, its negotiation, and its approval by the Medco board of directors; that the Medco directors were not adequately informed and did not adequately inform themselves of all reasonably available information before recommending the transaction to Medco shareholders; and that the Medco directors were disloyal and committed waste in allegedly enabling one of the Medco directors to negotiate the transaction purportedly for his own benefit and in agreeing to terms that precluded what the complaint alleged were more beneficial alternative transactions. SWIB also moved for a preliminary injunction to enjoin the shareholder vote and the merger based on the claims asserted in its complaint. Medco and the other defendants denied all allegations and continue to deny them.

After Medco distributed a supplemental proxy statement on January 31, 2000 and the court postponed the February 10, 2000 vote on the merger agreement for 15 days to allow shareholders sufficient time to consider the supplemental disclosures, the court rejected SWIB's claims in a February 24, 2000 Memorandum Opinion and denied preliminary injunctive relief because SWIB had not shown a reasonable likelihood of success following trial on the merits. The court made a number of preliminary findings, including that the Medco board of directors properly delegated to one of its directors the responsibility to negotiate the merger; that the payment of the negotiating fee was a proper exercise of business judgment and did not constitute waste; that the other merger provisions were also valid; that the Medco directors were adequately informed of all material information reasonably available to them prior to approving the merger

agreement; that the Medco directors acted independently and in good faith to benefit the economic interests of the Medco shareholders; that the alleged omissions in the proxy statements were not material; and that the Medco board of directors fully met its duty of complete disclosure with respect to the transaction.

SWIB has filed an Application for a Scheduling Order stating its intention to dismiss the case, before a class has been certified, without prejudice. In the meantime, the action is still pending. While SWIB has indicated that it does not intend to prosecute the merits of the case further, another shareholder could intervene and continue the action. Even though SWIB lost its motion for preliminary injunction, and is going to dismiss the case, SWIB has claimed that its attorneys are entitled to an award of attorney's fees and costs. SWIB has petitioned the court for approximately $7.26 million in attorney's fees and approximately $270,000 in costs.

A hearing on SWIB's petition to dismiss and for attorney's fees and costs was held on June 26, 2000 in the Court of Chancery for the State of Delaware. No ruling has yet been issued.

The Company believes that SWIB's case, including SWIB's claim for significant attorney's fees which includes fees based on a formula related to an alleged benefit conferred on Medco shareholders, is meritless, and the Company is vigorously contesting it. The Company believes SWIB's actions did not confer a benefit on the Medco shareholders. The Company also believes it is unlikely that another shareholder will intervene to continue the action, but if that results then the Company will vigorously contest it.

Other

The Parkedale Facility was one of six facilities owned by Pfizer subject to a Consent Decree of Permanent Injunction issued August 1993 in United States of America v. Warner-Lambert Company and Melvin R. Goodes and Lodewijk J.R. DeVink (U.S. Dist. Ct., Dist. of N.J.) (the "Consent Decree"). The Parkedale Facility is currently manufacturing pharmaceutical products subject to the Consent Decree which prohibits the manufacture and delivery of specified drug products unless, among other things, the products conform to current good manufacturing practices and are produced in accordance with an approved abbreviated new drug application or new drug application. The Company intends, when appropriate, to petition for relief from the Consent Decree.

The Company is involved in various routine legal proceedings incident to the ordinary course of its business.

Summary

Management believes that the outcome of all pending legal proceedings in the aggregate will not have a material adverse affect on the Company's consolidated financial position, results of operations, or cash flow.

7. LONG-TERM DEBT

Long-term debt consists of the following:

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
Senior subordinated notes	$ 96,382	$ 96,382
Notes payable to former owners, due in equal annual installments of principal and interest (at a rate of 6%) of $1,226 through December 2003	3,276	3,276
Various capital leases with interest rates ranging from 8.3% to 12.7% and maturing at various times through 2002	490	869
Other notes payable	--	5
	100,148	100,532
Less current portion	1,509	1,527
	$ 98,639	$ 99,005

As a result of prepayments under the Senior Credit Facility, during the three months and nine months ended September 30, 2000, an extraordinary charge of $2.6 million and $7.2 million, net of related tax benefits, associated with the write-off of certain unamortized deferred financing costs was recorded.

As of September 30, 2001 the Company has $100.0 million of availability under the Senior Credit Facility. See footnote 14 for subsequent events.

8. SEGMENT REPORTING

The Company's business is classified into three reportable segments; Branded Pharmaceuticals, Contract Manufacturing, and Licensed Products. Branded Pharmaceuticals include a variety of branded prescription products over four therapeutic areas, including cardiovascular, women's health/endocrinology, anti-infective and critical care. Contract Manufacturing represents contract manufacturing services provided for pharmaceutical and biotechnology companies. Licensed products represent products for which the Company has transferred the manufacturing and marketing rights to corporate partners in exchange for royalty payments

on product sales. The classification "all other" primarily includes generic pharmaceutical products and development services.

The Company primarily evaluates its segments based on gross profit. Reportable segments were separately identified based on revenues, gross profit and total assets.

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

THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
2001	2000	2001	2000

Total Revenues:				
Branded pharmaceuticals	$211,479	$143,765	$560,096	$373,203
Licensed products	11,608	9,219	36,028	32,090
Contract manufacturing	22,252	15,421	53,450	47,088
All other	702	848	2,204	6,103
Eliminations	(15,952)	(3,711)	(33,863)	(14,305)
Consolidated total revenues	$230,089	$165,542	$617,915	$444,179
Gross profit:				
Branded pharmaceuticals	$172,518	$ 89,471	$462,841	$275,718
Licensed products	9,961	7,305	29,218	26,669
Contract manufacturing	(1,793)	2,809	(5,461)	5,301
All other	(4)	175	150	2,748
Consolidated gross profit	$180,682	$ 99,760	$486,748	$310,436

	AS OF SEPTEMBER 30, 2001	AS OF DECEMBER 31, 2000
Total assets:		
Branded pharmaceuticals	$1,409,323	$1,189,997
Licensed products	13,361	10,723
Contract manufacturing	103,526	82,314
All other	84	720
Eliminations	(2,181)	(1,359)
Consolidated total assets	$1,524,113	$1,282,395

The following represents revenues by therapeutic area:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
Total Revenues:				
Cardiovascular	$ 93,480	$ 62,040	$246,534	$150,866
Women's health/endocrinology	61,361	45,373	156,916	113,028
Anti-infective	36,268	23,752	107,792	75,758
Critical care	24,500	15,963	63,476	46,569
Other	14,480	18,414	43,197	57,958
Consolidated total revenues	$230,089	$165,542	$617,915	$444,179

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

9. CO-PROMOTION AGREEMENT WITH AHP

On June 22, 2000, the Company entered into a co-promotion agreement with American Home Products Corporation ("AHP") to promote Altace(R) in the United States and Puerto Rico through October 29, 2008. Under the agreement, AHP and the Company have agreed to share various marketing expenses related to the promotion of Altace(R). The Company's share of these expenses are included in the caption "Co-promotion marketing expense" in the accompanying financial statements. In addition, AHP paid an up front fee of $75.0 million to King which was classified as other liabilities and is being amortized over the life of the agreement. The amortization is included as a reduction of Co-promotion marketing expense in the accompanying financial statements.

In connection with the co-promotion agreement with AHP, the Company has agreed to pay AHP a promotional fee as follows:

- For 2001 and 2002, 20% of net sales up to $165 million, 50% of net sales from $165 million to $465 million and 52.5% of net sales in excess of $465 million.

- For years subsequent to 2002 through 2008 the fee is based on the same formula, except the fee for the first $165 million will be 15% of net sales.

The co-promotion fee is being accrued quarterly based on a percentage of net sales at a rate equal to the expected relationship of the expected co-promotion fee for the year to applicable expected net sales for the year.

10. STOCK SPLIT

On June 20, 2001, the Company's Board of Directors declared a four for three stock split for shareholders of record as of July 3, 2001, to be distributed July 19, 2001. The stock split has been reflected in all share data contained in these consolidated financial statements.

11. OTHER THIRD QUARTER TRANSACTIONS

In the third quarter, the Company recognized a gain of approximately $6.2 million on its primary derivative, a $20.0 million convertible senior note from Novavax, Inc., which has been recognized as other income in the accompanying financial statements.

The Company incurred a non-recurring inventory charge of $2.1 million in the third quarter related to the write-off of obsolete Levoxyl(R) inventory. The U.S. Food and Drug Administration ("FDA") approved the new drug application for a new formulation of Levoxyl(R) on May 25, 2001. Pursuant to FDA guidance, the Company may distribute only the FDA approved new formulation of Levoxyl(R) after August 14, 2001. This non-recurring charge is included in total cost of revenues in the accompanying financial statements.

12. NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations." SFAS No. 141 requires all business combinations to be accounted for under the purchase method of accounting. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001, as well as all business combinations accounted for under the purchase method of accounting for which the date of acquisition is July 1, 2001, or later.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 modifies the accounting and reporting for acquired intangible assets at the time of acquisition and in subsequent periods. Intangible assets which have finite lives must be amortized over their estimated useful life. Intangible assets with indefinite lives will not be amortized, but evaluated annually

for impairment. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. In accordance with SFAS 142, the Company has implemented the standard for acquisitions in the third quarter of 2001 related to the Corgard(R), Corzide(R), Delestrogen(R) and Florinef(R) products. The purchase price allocation among the products acquired, the determination as to whether the useful life is indefinite or finite and the assignment of lives to the intangibles designated as having finite lives under SFAS No. 142 are preliminary and subject to further evaluation and interpretation. The Company is in the process of reviewing the impact of this pronouncement on previous acquisitions.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations" and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company is in the process of reviewing the impact of these pronouncements.

13. GUARANTOR FINANCIAL STATEMENTS

The Company's wholly-owned subsidiaries Monarch Pharmaceuticals, Inc., King Pharmaceuticals Research and Development, Inc., Parkedale Pharmaceuticals, Inc., Jones Pharma Incorporated and King Pharmaceuticals of Nevada, Inc. (the "Guarantor Subsidiaries") have guaranteed the Company's performance under the $150,000, 10 3/4% Senior Subordinated Notes due 2009 on a joint and several basis. There are no restrictions under the Company's financing arrangements on the ability of the Guarantor Subsidiaries to distribute funds to the Company in the form of cash dividends, loans or advances. The following combined financial data provides information regarding the financial position, results of operations and cash flows of the Guarantor Subsidiaries (condensed consolidating financial data). Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that such information would not be material to the holders of the notes.

GUARANTOR SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEETS

	DECEMBER 31, 2000	SEPTEMB

	KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED	KING
					(UN
ASSETS					
Current assets:					
Cash and cash equivalents	$ 82,316	$ (5,921)	$ --	$ 76,395	$ 25,677
Accounts receivable, net	7,027	115,034	(1,359)	120,702	5,761
Inventories	3,856	61,233	--	65,089	22,065
Deferred income taxes	23,939	2,794	--	26,733	14,234
Prepaid expenses and other current assets	39,637	(11,313)	--	28,324	2,352
Total current assets	156,775	161,827	(1,359)	317,243	70,089
Property, plant, and equipment, net	28,831	99,690	--	128,521	38,041
Intangible assets, net	418,895	371,429	--	790,324	688,771
Investment in subsidiaries	911,602	--	(911,602)	--	1,146,248
Other assets	24,940	21,367	--	46,307	43,851
Total assets	$1,541,043	$ 654,313	$ (912,961)	$1,282,395	$1,987,000
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Accounts payable	$ 2,080	$ 24,289	$ (1,359)	$ 25,010	$ 2,542
Accrued expenses	13,048	65,497	--	78,545	3,050
Income taxes payable	--	--	--	--	(10,700
Current portion of long-term debt	1,498	29	--	1,527	1,489
Total current liabilities	16,626	89,815	(1,359)	105,082	(3,619
Long-term debt	98,992	13	--	99,005	98,639
Deferred income taxes	14,592	2,397	--	16,989	14,592
Other liabilities	71,714	1,872	--	73,586	66,327
Intercompany (receivable) payable	351,386	(351,386)	--	--	634,008
Total liabilities	553,310	(257,289)	(1,359)	294,662	809,947
Shareholders' equity	987,733	911,602	(911,602)	987,733	1,177,053
Total liabilities and shareholders' equity	$1,541,043	$ 654,313	$ (912,961)	$1,282,395	$1,987,000

SEPTEMBER 30, 2001	
ELIMINATING ENTRIES	KING CONSOLIDATED

(UNAUDITED)

ASSETS		
Current assets:		
Cash and cash equivalents	$ --	$ 19,986
Accounts receivable, net	(2,181)	131,533
Inventories	--	96,972
Deferred income taxes	--	16,862
Prepaid expenses and other current assets	--	6,005
Total current assets	(2,181)	271,358
Property, plant, and equipment, net	--	138,977
Intangible assets, net	--	1,047,965
Investment in subsidiaries	(1,146,248)	--
Other assets	--	65,813
Total assets	$(1,148,429)	$1,524,113
LIABILITIES AND SHAREHOLDERS		
Current liabilities:		
Accounts payable	$ (2,181)	$ 17,104
Accrued expenses	--	107,218
Income taxes payable	--	39,189
Current portion of long-term debt	--	1,509
Total current liabilities	(2,181)	165,020
Long-term debt	--	98,639
Deferred income taxes	--	17,074
Other liabilities	--	66,327
Intercompany (receivable) payable	--	--
Total liabilities	(2,181)	347,060
Shareholders' equity	(1,146,248)	1,177,053
Total liabilities and shareholders' equity	$(1,148,429)	$1,524,113

GUARANTOR SUBSIDIARIES
CONSOLIDATING STATEMENTS OF INCOME

	THREE MONTHS ENDED SEPTEMBER 30, 2000			
	KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED
	(UNAUDITED)			
Revenues:				
Net sales	$ 3,984	$154,585	$(2,246)	$156,323
Royalty revenue	--	9,219	--	9,219
Total revenues	3,984	163,804	(2,246)	165,542
Operating costs and expenses:				
Costs of revenues	4,174	63,854	(2,246)	65,782
Selling, general and administrative (including co-promotion expenses)	3,560	27,599	--	31,159
Depreciation and amortization	5,659	6,149	--	11,808
Research and development	315	5,704	--	6,019
Research and development -- Special license rights	--	--	--	--
Nonrecurring charge -- research and development	--	6,107	--	6,107
Merger, restructuring and other nonrecurring charges	(26,034)	68,383	--	42,349
Total operating costs and expenses	(12,326)	177,796	(2,246)	163,224
Operating income	16,310	(13,992)	--	2,318
Other income (expense):				
Interest income	385	2,720	--	3,105
Interest expense	(9,683)	(1)	--	(9,684)
Other, net	2,564	(279)	--	2,285
Equity in earnings of subsidiaries	(12,634)	--	12,634	--
Intercompany interest (expense)	1,793	(1,793)	--	--
Total other income (expense)	(17,575)	647	12,634	(4,294)
Income before income taxes and extraordinary item	(1,265)	(13,345)	12,634	(1,976)
Income tax (expense) benefit	(7,892)	711	--	(7,181)

Income before extraordinary item....	(9,157)	(12,634)	12,634	(9,157)
Extraordinary item.....	(11,914)	--	--	(11,914)
Net income.....	$(21,071)	$(12,634)	$12,634	$(21,071)

	THREE MONTHS ENDED SEPTEMBER 30, 2001			
	KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED
	(UNAUDITED)			
Revenues:				
Net sales.....	$ 7,220	$217,190	$ (5,929)	$218,481
Royalty revenue.....	--	11,608	--	11,608
Total revenues.....	7,220	228,798	(5,929)	230,089
Operating costs and expenses:				
Costs of revenues.....	7,340	47,996	(5,929)	49,407
Selling, general and administrative (including co-promotion expenses).....	1,843	59,782	--	61,625
Depreciation and amortization.....	6,199	6,486	--	12,685
Research and development.....	2,500	4,917	--	7,417
Research and development -- Special license rights.....	--	--	--	--
Nonrecurring charge -- research and development.....	--	--	--	--
Merger, restructuring and other nonrecurring charges.....	(361)	3,640	--	3,279
Total operating costs and expenses.....	17,521	122,821	(5,929)	134,413
Operating income.....	(10,301)	105,977	--	95,676
Other income (expense):				
Interest income.....	1,719	445	--	2,164
Interest expense.....	(3,442)	84	--	(3,358)
Other, net.....	5,750	(2,192)	--	3,558
Equity in earnings of subsidiaries.....	62,810	--	(62,810)	--
Intercompany interest (expense).....	4,139	(4,139)	--	--
Total other				

income (expense).....	70,976	(5,802)	(62,810)	2,364
Income before income taxes and extraordinary item....	60,675	100,175	(62,810)	98,040
Income tax (expense) benefit.....	796	(37,365)	--	(36,569)
Income before extraordinary item....	61,471	62,810	(62,810)	61,471
Extraordinary item.....	--	--	--	--
Net income.....	$ 61,471	$ 62,810	$(62,810)	$ 61,471

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

GUARANTOR SUBSIDIARIES

CONSOLIDATING STATEMENTS OF INCOME

	NINE MONTHS ENDED SEPTEMBER 30, 2000			
	KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED
	(UNAUDITED)			
Revenues:				
Net sales.....	$ 15,838	$401,470	$ (5,219)	$412,089
Royalty revenue.....	--	32,090	--	32,090
Total revenues.....	15,838	433,560	(5,219)	444,179
Operating costs and expenses:				
Costs of revenues.....	13,103	125,859	(5,219)	133,743
Selling, general and administrative.....	10,825	84,335	--	95,160
Depreciation and amortization.....	16,135	14,451	--	30,586
Research and development.....	848	14,852	--	15,700
Nonrecurring charge-research and development.....	--	6,107	--	6,107
Merger, restructuring and other nonrecurring charges.....	(19,809)	84,452	--	64,643
Total operating costs and expenses.....	21,102	330,056	(5,219)	345,939
Operating income.....	(5,264)	103,504	--	98,240

Other income(expense):				
Interest income	982	9,127	--	10,109
Interest expense	(33,837)	(3)	--	(33,840)
Other, net	2,478	(307)	--	2,171
Equity in earnings of subsidiaries	72,773	--	(72,773)	--
Intercompany interest (expense)	4,148	(4,148)	--	--
Total other income(expense)	46,544	4,669	(72,773)	(21,560)
Income before income taxes, extraordinary item and cumulative effect of charge in accounting principle	41,280	108,173	(72,773)	76,680
Income tax (expense) benefit	(9,521)	(35,400)	--	(44,921)
Income before extraordinary item and cumulative effect of charge in accounting principle	31,759	72,773	(72,773)	31,759
Extraordinary item	(16,599)	--	--	(16,599)
Cumulative effect of charge in accounting principle	--	--	--	--
Net income	$ 15,160	$ 72,773	$(72,773)	$ 15,160

	NINE MONTHS ENDED SEPTEMBER 30, 2001			
	KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED
	(UNAUDITED)			
Revenues:				
Net sales	$ 18,978	$578,140	$ (15,231)	$581,887
Royalty revenue	--	36,028	--	36,028
Total revenues	18,978	614,168	(15,231)	617,915
Operating costs and expenses:				
Costs of revenues	18,738	127,660	(15,231)	131,167
Selling, general and administrative	4,999	167,324	--	172,323
Depreciation and amortization	16,870	18,611	--	35,481
Research and development	5,198	12,734	--	17,932
Nonrecurring charge-research and development	3,000	--	--	3,000
Merger, restructuring and other nonrecurring charges	(361)	3,640	--	3,279

Total operating costs and expenses.....	48,444	329,969	(15,231)	363,182
Operating income.....	(29,466)	284,199	--	254,733
Other income(expense):				
Interest income.....	6,488	1,255	--	7,743
Interest expense.....	(9,364)	415	--	(8,949)
Other, net.....	8,742	(2,240)	--	6,502
Equity in earnings of subsidiaries.....	199,002	--	(199,002)	--
Intercompany interest (expense).....	10,671	(10,671)	--	--
Total other income(expense)...	215,539	(11,241)	(199,002)	5,296
Income before income taxes, extraordinary item and cumulative effect of charge in accounting principle.....	186,073	272,958	(199,002)	260,029
Income tax (expense) benefit.....	(23,035)	(73,956)	--	(96,991)
Income before extraordinary item and cumulative effect of charge in accounting principle.....	163,038	199,002	(199,002)	163,038
Extraordinary item.....	--	--	--	--
Cumulative effect of charge in accounting principle...	(545)	--	--	(545)
Net income.....	$162,493	$199,002	$(199,002)	$162,493

KING PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

GUARANTOR SUBSIDIARIES

CONSOLIDATING STATEMENTS OF CASH FLOWS

	NINE MONTHS ENDED SEPTEMBER 30, 2000			
	KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED
	(UNAUDITED)			
Net cash flows (used in) provided by operating activities.....	$ (48,391)	$ 141,245	$ --	$ 92,854
Cash flows from investing activities:				

Purchase of investment securities	--	(142,922)	--	(142,922)
Proceeds from maturity and sale of investment securities	--	258,020	--	258,020
Loans receivable	--	--	--	--
Convertible senior note	--	--	--	--
Purchases of property, plant and equipment	(3,143)	(9,973)	--	(13,116)
Purchases of intangible assets	--	(204,000)	--	(204,000)
Intercompany transfer of property, plant and equipment	--	--	--	--
Proceeds from sale of products	--	--	--	--
Proceeds from sale of assets	398	43	--	441
Net cash (used in) provided by investing activities	(2,745)	(98,832)	--	(101,577)
Cash flows from financing activities:				
Proceeds from revolving credit facility	114,000	--	--	114,000
Payments on revolving credit facility	(159,000)	--	--	(159,000)
Proceeds from issuance of common shares and exercise of stock options, net	259,991	3,166	--	263,157
Payments of cash dividends -- Jones	--	(2,619)	--	(2,619)
Payment of senior subordinated	--	--	--	--
Payments on other long-term debt	(354,621)	(20)	--	(354,641)
Proceeds from bridge loan facility	25,000	--	--	25,000
Debt issuance costs	(850)	--	--	(850)
Other	--	--	--	--
Intercompany	164,181	(164,181)	--	--
Net cash provided by (used in) financing activities	48,701	(163,654)	--	(114,953)
Increase in cash and cash equivalents	(2,435)	(121,241)	--	(123,676)
Cash and cash equivalents, beginning of period	11,683	120,040	--	131,723
Cash and cash equivalents, end of period	$ 9,248	$ (1,201)	$ --	$ 8,047

NINE MONTHS ENDED SEPTEMBER 30, 2001			
KING	GUARANTOR SUBSIDIARIES	ELIMINATING ENTRIES	KING CONSOLIDATED
(UNAUDITED)			

Net cash flows (used in) provided by operating activities	$ (55,396)	$ 306,019	$ --	$ 250,623
Cash flows from investing activities:				
Purchase of investment securities	--	--	--	--
Proceeds from maturity and sale of investment securities	--	--	--	--
Loans receivable	--	(15,000)	--	(15,000)
Convertible senior note	(10,000)	--	--	(10,000)
Purchases of property, plant and equipment	(10,599)	(9,623)	--	(20,222)
Purchases of intangible assets	(286,500)	--	--	(286,500)
Intercompany transfer of property, plant and equipment	(223)	223	--	--
Proceeds from sale of products	3,332	--	--	3,332
Proceeds from sale of assets	--	1,446	--	1,446
Net cash (used in) provided by investing activities	(303,990)	(22,954)	--	(326,944)
Cash flows from financing activities:				
Proceeds from revolving credit facility	75,000	--	--	75,000
Payments on revolving credit facility	(75,000)	--	--	(75,000)
Proceeds from issuance of common shares and exercise of stock options, net	21,689	--	--	21,689
Payments of cash dividends -- Jones	--	--	--	--
Payment of senior subordinated	--	--	--	--
Payments on other long-term debt	(362)	(22)	--	(384)
Proceeds from bridge loan facility	--	--	--	--
Debt issuance costs	--	--	--	--
Other	(1,393)	--	--	(1,393)
Intercompany	282,813	(282,813)	--	--
Net cash provided by (used in) financing activities	302,747	(282,835)	--	19,912
Increase in cash and cash equivalents	(56,639)	230	--	(56,409)
Cash and cash equivalents, beginning of period	82,316	(5,921)	--	76,395
Cash and cash equivalents, end of period	$ 25,677	$ (5,691)	--	$ 19,986

13. SUBSEQUENT EVENTS

On November 7, 2001 the Company completed the sale of 16,000,000 newly issued shares of common stock for $38.00 per share ($36.72 per share net of commissions and expenses) resulting in net proceeds of $587.5 million.

Additionally on November 7, 2001 the Company issued $300 million of 2 3/4% Convertible Debentures due November 15, 2021. The debentures are unsecured unsubordinated obligations and the payment of principal and interest is guaranteed by the Company's domestic subsidiaries on a joint and several basis. The debentures accrue interest at an initial rate of 2 3/4%, which will be reset (but not below 2 3/4% or above 4 1/2%) on May 15, 2006, May 15, 2011, and May 15, 2016. Interest is payable on May 15 and November 15 of each year.

On or after November 20, 2006, the Company may redeem for cash all or part of the debentures that have not previously been converted or repurchased at a price equal to 100% of the principal amount of the debentures plus accrued interest up to but not including the date of redemption. Holders may require us to repurchase for cash all or part of their debentures on November 15, 2006, November 15, 2011 or November 15, 2016, at a price equal to 100% of the principal amount of the debentures plus accrued interest up to but not including the date of repurchase. In addition, upon a change of control, each holder may require us to repurchase for cash all or a portion of the holder's debentures.

Holders may surrender their debentures for conversion into shares of King common stock at the conversion price (initially $50.16 per share and subject to certain adjustments) if any of the following conditions is satisfied:

- if the closing sale price of King common stock, for at least 20 trading days in the 30 trading day period ending on the trading day prior to the date of surrender, exceeds 110% of the conversion price per share of King common stock on that preceding trading day;

- if we have called the debentures for redemption; or

- upon the occurrence of specified corporate transactions.

The Company has reserved 5,980,861 shares of common stock in the event such debentures are converted into shares of the Company's common stock.

On November 9, 2001, the Company announced its intention to tender for the remaining $96.4 million of 10 3/4% senior subordinated notes due 2009. As a result, the Company expects to record an extraordinary charge of approximately $13.0 to 14.0 million after tax, or $0.05 to $0.06 per share, in the fourth quarter of 2001.

On November 5, 2001, the Company terminated the senior credit facility, including the revolver.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND

FINANCIAL CONDITION

The following discussion contains certain forward-looking statements that reflect management's current views of future events and operations. This discussion should be read in conjunction with the following: (a) "Risk Factors" set out below and other sections of our Annual Report on Form 10-K/A for the year ended December 31, 2000, which are supplemented by the discussion which follows; (b) our audited consolidated financial statements which are included in our Annual Report on Form 10-K/A for the year ended December 31, 2000; and (c) our unaudited consolidated financial statements and related notes thereto included in this report.

OVERVIEW

General

The following summarizes net revenues by operating segment (in thousands).

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
Branded pharmaceuticals	$211,479	$143,765	$559,378	$373,203
Licensed products	11,608	9,219	36,028	32,090
Contract manufacturing	6,300	11,710	20,305	32,783
Other	702	848	2,204	6,103
Total	$230,089	$165,542	$617,915	$444,179

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000

Revenues

Net revenues increased $64.6 million, or 39.0%, to $230.1 million in 2001 from $165.5 million in 2000, due primarily to the acquisition and growth of branded pharmaceutical products.

Net sales from branded pharmaceutical products increased $67.7 million, or 47.1%, to $211.5 million in 2001 from $143.8 million in 2000. This increase was due primarily to growth in net sales of Altace(R), and Levoxyl(R). While we expect continued growth in net sales of our branded pharmaceuticals in the future, we refer you to the "Risk Factors" that appear below, particularly those related to Altace(R) and Levoxyl(R), that could cause results to differ.

Revenues from licensed products increased $2.4 million, or 26.1%, to $11.6 million in 2001 from $9.2 million in 2000.

Revenues from contract manufacturing and other decreased $5.6 million, or 44.4%, to $7.0 million in 2001 from $12.6 million in 2000, primarily due to (1) the conclusion of two manufacturing and supply agreements during the fourth quarter of 2000; and (2) reduced revenues derived under a third manufacturing and supply agreement during the third quarter of 2001 as compared to the third quarter of 2000. While contract manufacturing and generic pharmaceutical sales remain a part of our business, we do not consider contract manufacturing and

generic pharmaceutical sales as significant components of our growth strategy.

Operating Costs and Expenses

Total operating costs and expenses decreased $28.8 million, or 17.6%, to $134.4 million in 2001 from $163.2 million in 2000. The decrease was primarily due to merger, restructuring and other nonrecurring charges of $77.2 million during the third quarter of 2000, partially offset by $28.5 million in co-promotion fees

and marketing expense in 2001 primarily related to the co-promotion agreement with American Home Products Corporation for the promotion of Altace(R) in the United States and Puerto Rico.

Cost of revenues decreased $16.4 million, or 24.9% to $49.4 million in 2001 from $65.8 million in 2000. The decrease is due to $28.7 million of nonrecurring write-off of inventory charges related to the discontinuance of Fluogen(R) during the third quarter of 2000. On September 27, 2000, we received notification from the FDA that we must cease manufacturing and distribution of Fluogen(R), an influenza vaccine, until we demonstrate compliance with related FDA regulations. In addition, the notification recommended that we properly dispose of Fluogen(R) inventory on hand. As a result of this notification, we decided to permanently discontinue Fluogen(R) production and distribution. We recorded a nonrecurring write-off of inventory associated with these events (the "FDA Fluogen(R) Notification"). This decrease was partially offset by a nonrecurring write-off of obsolete Levoxyl(R) inventory of $2.1 million in the third quarter of 2001. The FDA approved the new drug application for a new formulation of Levoxyl(R) on May 25, 2001. Pursuant to FDA guidance, we may distribute only the FDA approved new formulation of Levoxyl(R) after August 14, 2001. Excluding the nonrecurring inventory write-off charges described above, cost of revenues increased $10.2 million, or 27.5%, to $47.3 million in 2001 from $37.1 million in 2000. The increase resulted from cost of revenues associated with the increase in net sales of branded pharmaceutical products described above. As a percentage of revenues, excluding the nonrecurring inventory write-off charges described above, cost of revenues decreased to 20.6% in 2001 from 22.4% in 2000 due to the increase in sales of higher profit margin products.

Selling, general and administrative expenses remained relatively flat at $33.1 million in 2001 as compared to $31.2 million in 2000. As a percentage of revenues, selling, general, and administrative expenses decreased to 14.4% in 2001 from 18.8% in 2000 due to increased revenues, realization of cost synergies from the Medco and Jones mergers, and the classification of all Altace(R) related marketing expenses as co-promotion marketing expense rather than selling, general and administrative during the three months ended September 30, 2001.

During the three months ended September 30, 2001, we incurred $24.7 million in co-promotion fees and $3.8 million in co-promotion marketing expense primarily pursuant to the Co-Promotion Agreement with American Home Products for the promotion of Altace(R) in the United States and Puerto Rico.

Depreciation and amortization expense increased $0.9 million, or 7.6%, to $12.7 million in 2001 from $11.8 million in 2000. The increase was due primarily to additional amortization expense resulting from the acquisition of Corgard(R) and Corzide(R) in August 2001.

Research and development expense increased to $7.4 million in 2001 from $6.0 million in 2000. During the three months ended September 30, 2000, we

incurred a nonrecurring research and development charge of $6.1 million related to our decision to discontinue the development of Pallacor(TM).

During the three months ended September 30, 2000, we incurred merger, restructuring, and other nonrecurring charges of $42.4 million. These charges related to merger and restructuring costs of $33.8 million associated with our tax-free pooling of interests transaction with Jones during August 2000 and other restructuring activities, and restructuring and nonrecurring charges of $8.6 million related to employee severance arising from our decision to discontinue Fluogen(R). During the three months ended September 30, 2001, we incurred merger, restructuring, and other nonrecurring charges of $3.3 million related to employee severance arising from the Jones merger.

Operating Income

Operating income increased $93.4 million to $95.7 million in 2001 from $2.3 million in 2000. This increase was primarily due to the $77.2 million of nonrecurring charges incurred in the three months ended September 30, 2000 described above, as well as the increase in branded pharmaceutical sales during the three months ended September 30, 2001 as compared to the three months ended September 30, 2000, partially offset by $28.5 million of co-promotion fees and marketing expenses in 2001.

Other Income(Expense)

Interest income decreased $0.9 million, or 29.0%, to $2.2 million in 2001 compared to $3.1 million in 2000.

Interest expense decreased $6.3 million, or 64.9%, to $3.4 million in 2001 from $9.7 million in 2000. This decrease is due to the reduced average debt balance in 2001 resulting from our prepayment of debt obligations during 2000.

Other income increased $1.3 million to $3.6 million in 2001, from $2.3 million in 2000, primarily due to an unrealized gain of approximately $6.2 million on our primary derivative, a $20.0 million convertible senior note from Novavax, Inc.

Income Tax Expense

The effective tax rate in 2001 was 37.3%. The rate in 2000 was higher than the statutory rate due to nondeductible merger related costs.

Extraordinary Item

During the third quarter of 2000, we repaid outstanding debt under our senior credit facility prior to maturity. The early repayment caused us to recognize in the third quarter of 2000 an extraordinary loss of $2.6 million, net of related tax benefits of $1.5 million, from the write-off of related deferred financing costs. We also recorded extraordinary losses on impaired assets associated with the FDA Fluogen(R) Notification of $9.4 million, net of related tax benefits of $5.6 million, in the third quarter of 2000.

Net Income

Due to the factors set forth above, net income increased $82.6 million to $61.5 million in 2001 from a loss of $21.1 million in 2000.

NINE MONTHS ENDED SEPTEMBER 30, 2001 AND 2000

Revenues

Net revenues increased $173.7 million, or 39.1%, to $617.9 million in 2001 from $444.2 million in 2000, due primarily to the acquisition and growth of branded pharmaceutical products.

Net sales from branded pharmaceutical products increased $186.2 million, or 49.9%, to $559.4 million in 2001 from $373.2 million in 2000. This increase was due primarily to growth in net sales of Altace(R) and Levoxyl(R). While we expect continued growth in net sales of our branded pharmaceuticals in the future, we refer you to the "Risk Factors" that appear below, particularly those related to Altace(R) and Levoxyl(R), that could cause results to differ.

Revenues from licensed products increased $3.9 million, or 12.1%, to $36.0 million in 2001 from $32.1 million in 2000, primarily due to an increase in the net sales of Adenoscan(R) and Adenocard(R), on which we receive royalty revenues. The increase in revenues from licensed products was affected by a contractual reduction in the percentage royalty we receive on net sales of Adenoscan(R) that became effective during the third quarter of 2000.

Revenues from contract manufacturing and other decreased $16.4 million, or 42.2%, to $22.5 million in 2001 from $38.9 million in 2000, primarily due to (1) the conclusion of two manufacturing and supply agreements during the fourth quarter of 2000; (2) reduced revenues derived under two additional manufacturing and supply agreements during the nine months ended September 30, 2001, as compared to the same period of the prior year; and (3) reduced sales of generic private label neomycin and polymyxin B sulfates and hydrocortisone suspension and solution. While contract manufacturing and generic pharmaceutical sales remain a part of our business, we do not consider contract manufacturing and generic pharmaceutical sales as significant components of our growth strategy.

Operating Costs and Expenses

Total operating costs and expenses increased $17.3 million, or 5.0%, to $363.2 million in 2001 from $345.9 million in 2000. The increase was primarily due to $76.9 million in co-promotion fees and marketing expense in 2001 primarily related to the co-promotion agreement with American Home Products for the promotion of Altace(R) in the United States and Puerto Rico, an increase of $24.1 million in cost of sales excluding nonrecurring charges, an increase of $4.9 million in depreciation and amortization expenses, offset by $99.5 million of merger and other nonrecurring charges in 2000.

Cost of revenues decreased $2.5 million, or 1.9% to $131.2 million in 2001 from $133.7 million in 2000. The decrease is due to $28.7 million of nonrecurring write-off of inventory charges related to the FDA Fluogen(R) Notification during the third quarter of 2000. This decrease was partially offset by a nonrecurring write-off of obsolete Levoxyl(R) inventory of $2.0 million in the third quarter of 2001. Excluding the nonrecurring inventory write-off charges described above, cost of revenues increased $24.1 million, or 23.0%, to $129.1 million in 2001 from $105.0 million in 2000. The increase resulted from cost of revenues associated with the increase in net sales of branded pharmaceutical products described above. As a percentage of revenues, excluding the nonrecurring inventory write-off charges described above, cost of revenues decreased to 20.9% in 2001 from 23.6% in 2000 due to the increase in sales of higher margin products.

Selling, general and administrative expenses remained relatively flat at $95.5 million in 2001 as compared to $95.2 million in 2000. As a percentage of revenues, selling, general, and administrative expenses decreased to 15.5% in

2001 from 21.4% in 2000 due to increased revenues and the classification of all Altace(R) related marketing expenses as co-promotion marketing expense rather than selling, general and administrative during the nine months ended September 30, 2001, and realization of cost synergies from the Medco and Jones mergers.

During the nine months ended September 30, 2001, we incurred $62.6 million in co-promotion fees and $14.3 million in co-promotion marketing expense primarily pursuant to the June 2000 co-promotion agreement with American Home Products for the promotion of Altace(R) in the United States and Puerto Rico.

Depreciation and amortization expense increased $4.9 million, or 16.0%, to $35.5 million in 2001 from $30.6 million in 2000. The increase was due primarily to additional amortization expense resulting from the acquisitions in July 2000 and August 2001.

Research and development expense increased to $17.9 million in 2001 from $15.7 million in 2000. In June of 2001, we incurred $3.0 million of "research and development-special license rights" for fees we paid Novavax, Inc. as consideration for an agreement which (1) expands our exclusive license to promote, market, distribute and sell Estrasorb(TM) worldwide, following approval, except in the United States and Puerto Rico where the parties will co-market the product; and (2) grants us an additional exclusive worldwide license to promote, market and distribute Androsorb(TM), following approval, except in the United States and Puerto Rico where the parties will co-market the product. During the third quarter of 2000, we incurred a nonrecurring research and development charge of $6.1 million related to our decision to discontinue the development of Pallacor(TM).

During the nine months ended September 30, 2000, we incurred merger, restructuring, and other nonrecurring charges of $64.6 million. These charges related to merger and restructuring costs of $35.3 million associated with our tax-free pooling of interests transaction with Jones during August 2000 and other restructuring activities, restructuring and nonrecurring charges of $8.6 million related to employee severance arising from our decision to discontinue Fluogen(R), and $20.8 million of merger and restructuring costs associated with our tax-free pooling of interests transaction with Medco in February 2000. During the nine months ended September 30, 2001, we incurred merger, restructuring, and other nonrecurring charges of $3.3 million related to employee severance arising from the Jones merger.

Operating Income

Operating income increased $156.5 million, or 159.4%, to $254.7 million in 2001 from $98.2 million in 2000. This increase was due primarily to the increase in branded pharmaceutical sales during the nine months

ended September 30, 2001 as compared to the nine months ended September 30, 2000 as well as $99.5 million of merger restructuring and other non-recurring charges recorded in 2000 described above.

Other Income (Expense)

Interest income decreased $2.4 million from $10.1 million in 2000 to $7.7 million in 2001 due to lower balances of invested cash and cash equivalents as well as lower interest rates during the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000.

Interest expense decreased $24.9 million, or 73.7%, to $8.9 million in 2001 from $33.8 million in 2000. This decrease is due to the reduced average debt balance in 2001 resulting from the Company's prepayment of debt obligations

during 2000.

Other income increased from $2.2 million in 2000 to $6.5 million income in 2001 primarily due to unrealized gains on our derivatives.

Income Tax Expense

The effective tax rate in 2000 of 58.6% was reduced to 37.3% in 2001 due primarily to nondeductible merger, restructuring and other non-recurring charges in 2000.

Extraordinary Item

During the nine months ended September 30, 2000, we repaid outstanding debt under our senior credit facility prior to maturity. The early repayment caused us to recognize an extraordinary loss of $7.3 million, net of related tax benefits of $4.3 million, from the write-off of related deferred financing costs. We also recorded extraordinary losses on impaired assets associated with the FDA Fluogen(R) Notification of $9.4 million, net of related tax benefits of $5.6 million, in the nine months ended September 30, 2000.

Cumulative Effect of Accounting Change

We recognized an expense of $0.5 million, net of income taxes of $0.3 million, in 2001 due to the cumulative effect of a change in accounting principle as a result of the adoption of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 138, which establishes accounting and reporting standards for derivative instruments and hedging activities.

Net Income

Due to the factors set forth above, net income increased $147.3 million, or 969.1%, to $162.5 million in 2001 from $15.2 million in 2000.

LIQUIDITY AND CAPITAL RESOURCES

General

On November 7, 2001 we completed the sale of 16,000,000 newly issued shares of common stock for $38.00 per share ($36.72 per share net of expenses) resulting in net proceeds of $587.5 million. Additionally, on November 7, 2001 we issued $300 million of 2 3/4% Convertible Debentures due November 15, 2021.

On August 8, 2001, we acquired three branded pharmaceutical products and a fully paid license to a fourth product from Bristol-Myers Squibb ("BMS") for $285.0 million. The products acquired include BMS's rights in the United States to Corzide(R), Delestrogen(R), and Florinef(R). We also acquired a fully paid license to and trademark for Corgard(R) in the United States. The acquisition was financed with a combination of borrowings under our senior secured credit facility and cash on hand.

We believe that cash generated from operations and the cash obtained from the issuance of the equity and convertible debentures noted above are sufficient to finance our current operations and working capital requirements. However, in the event we make significant future acquisitions or change our capital structure,

we may be required to raise funds through additional borrowings or the issuance

of additional debt or equity securities.

At present, we are actively pursuing potential acquisitions that may require the use of substantial capital resources.

NINE MONTHS ENDED JUNE 30, 2001

As of September 30, 2001 we had available up to $100.0 million under our senior credit facility. On November 5, 2001, we terminated the senior credit facility.

We generated net cash from operations of $250.6 million for the nine months ended September 30, 2001. Our net cash provided from operations was primarily the result of $162.5 million in net income, adjusted for non-cash depreciation and amortization of $35.5 million, an adjustment to deferred income taxes of $10.0 million, a change in income taxes payable of $59.2 million, and an increase in accrued expenses of $29.2 million. Primary uses of cash flow included an increase in inventory of $21.4 million, an increase in accounts receivable of $12.4 million, a decrease in accounts payable of $7.6 million, amortization of deferred revenue of $6.8 million, and an unrealized gain on derivative instruments of $8.5 million.

Cash flows used in investing activities for the nine months ended September 30, 2001 was $326.9 million due to the purchase of intangible assets of $286.5 million, $20.2 million of capital expenditures, $15.0 million of loans receivable, and a $10.0 million convertible senior note, offset by $3.3 million received as proceeds from the sale of product rights and $1.4 million received as proceeds from the sale of assets.

Financing activities for the nine months ended September 30, 2001 provided $19.9 million comprised principally of $21.7 million from the exercise of employee stock options, $75.0 million in proceeds from the senior credit facility, offset by repayments of $75.0 million on the senior credit facility.

Certain Indebtedness and Other Matters

As of September 30, 2001, we had $100.1 million of long-term debt (including current portion) and we had available up to $100.0 million under our senior credit facility. The senior credit facility was terminated November 5, 2001. Our financing arrangements required us to maintain minimum net worth, debt to equity, cash flow and current ratio requirements. As of September 30, 2001, we were in compliance with these covenants.

On June 20, 2001, the board of directors declared a four for three stock split for shareholders of record as of July 3, 2001, to be distributed July 19, 2001. The stock split has been reflected in all share data contained in this report.

On November 7, 2001 we issued $300 million of 2 3/4% Convertible Debentures due November 15, 2021. The debentures are unsecured unsubordinated obligations and the payment of principal and interest is guaranteed by our domestic subsidiaries on a joint and several basis. The debentures accrue interest at an initial rate of 2 3/4%, which will be reset (but not below 2 3/4% or above 4 1/2%) on May 15, 2006, May 15, 2011, and May 15, 2016. Interest is payable on May 15 and November 15 of each year.

On or after November 20, 2006, we may redeem for cash all or part of the debentures that have not previously been converted or repurchased at a price equal to 100% of the principal amount of the debentures plus accrued interest up to but not including the date of redemption. Holders may require us to repurchase for cash all or part of their debentures on November 15, 2006, November 15, 2011 or November 15, 2016, at a price equal to 100% of the

principal amount of the debentures plus accrued interest up to but not including the date of repurchase. In addition, upon a change of control, each holder may require us to repurchase for cash all or a portion of the holder's debentures.

Holders may surrender their debentures for conversion into shares of our common stock at the conversion price (initially $50.16 per share and subject to certain adjustments) if any of the following conditions is satisfied:

- if the closing sale price of our common stock, for at least 20 trading days in the 30 trading day period ending on the trading day prior to the date of surrender, exceeds 110% of the conversion price per share of our common stock on that preceding trading day;

- if we have called the debentures for redemption; or

- upon the occurrence of specified corporate transactions.

We have reserved 5,980,861 shares of common stock in the event the debentures are converted into shares of our common stock.

On November 9, 2001, we announced our intention to tender for the remaining $96.4 million of 10 3/4% senior subordinated notes due 2009. As a result, we expect to record an extraordinary charge of approximately $13.0 to $14.0 million after tax, or $0.05 to $0.06 per share, in the fourth quarter of 2001.

Capital Expenditures

Capital expenditures, including capital lease obligations, were $6.1 million and $4.1 million for the three months ended September 30, 2001 and 2000, respectively, and $20.2 million and $13.1 million for the nine months ended September 30, 2001 and 2000, respectively. The principal capital expenditures included property and equipment purchases and building improvements.

IMPACT OF INFLATION

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

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires all business combinations to be accounted for under the purchase method of accounting. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001, as well as all business combinations accounted for under the purchase method of accounting for which the date of acquisition is July 1, 2001, or later.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 modifies the accounting and reporting for acquired intangible assets at the time of acquisition and in subsequent periods. Intangible assets which have finite lives must be amortized over their estimated useful life. Intangible assets with indefinite lives will not be amortized, but evaluated annually for impairment. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001.

In accordance with SFAS 142, the Company has implemented the standard for acquisitions in the third quarter of 2001 related to the Corgard(R), Corzide(R),

Delestrogen(R) and Florinef(R) products. The purchase price allocation among the products acquired, the determination as to whether the useful life is indefinite or finite and the assignment of lives to the intangibles designated as having finite lives under SFAS No. 142 are preliminary and subject to further evaluation and interpretation. We are in the process of reviewing the impact of this pronouncement on existing intangible assets.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations" and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 144 addresses

financial accounting and reporting for the impairment or disposal of long-lived assets. We are in the process of reviewing the impact of these pronouncements.

RISK FACTORS

The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. If any of the adverse events described in this "Risk Factors" section actually occurs, our business, results of operations and financial condition could be materially adversely affected, the trading price, if any, of our securities could decline and you might lose all or part of your investment.

RISKS RELATED TO OUR BUSINESS

IF SALES OF OUR MAJOR PRODUCTS OR ROYALTY PAYMENTS TO US DECREASE, OUR RESULTS OF OPERATIONS COULD BE ADVERSELY AFFECTED.

Altace(R) accounted for approximately 32% of our net sales for the nine months ended September 30, 2001, and Altace(R), Lorabid(R), Levoxyl(R), Thrombin-JMI(R), and royalty revenues collectively accounted for approximately 60% of our net sales during the same period. We believe that sales of these products will continue to constitute a significant portion of our total revenues for the foreseeable future. Accordingly, any factor adversely affecting sales of any of these products or products for which we receive royalty payments could have a material adverse effect on our business, financial condition, results of operations and cash flows.

WE MAY NOT ACHIEVE OUR INTENDED BENEFITS FROM THE MARKETING ALLIANCE WITH AMERICAN HOME PRODUCTS CORPORATION FOR THE PROMOTION OF ALTACE(R).

We entered into a marketing alliance with American Home Products Corporation for Altace(R). We call this marketing alliance the "Co-Promotion Agreement." We entered into this alliance partially because we believed a larger pharmaceutical company with more sales representatives and, in our opinion, with substantial experience in the promotion of pharmaceutical products to physicians would significantly increase the sales revenue potential of Altace(R). By efficiently co-marketing the new indications for Altace(R) which were approved by the U.S. Food and Drug Administration, which we refer to in this report as the "FDA," on October 4, 2000, we intend to increase the demand for the product. In the agreement, both of us have incentives to maximize the sales and profits of Altace(R) and to optimize the marketing of the product by coordinating our promotional activities.

Under the Co-Promotion Agreement, American Home Products and we agreed to

establish an annual budget of marketing expenses to cover, among other things, direct-to-consumer advertising, such as television advertisements and advertisements in popular magazines and professional journals. One of the goals of the direct-to-consumer advertising campaign is to encourage the targeted audience to ask their own physicians about Altace(R) and whether it might be of benefit for them. The direct-to-consumer campaign may not be effective in achieving this goal. Furthermore, the direct-to-consumer advertising campaign has not yet begun and the date for its launch is yet to be determined. Physicians may not prescribe Altace(R) for their patients to the extent we might otherwise hope if patients for whom Altace(R) is indicated do not ask their physicians about Altace(R).

It is possible that we or American Home Products or both of us will not be successful in effectively promoting Altace(R) or in optimizing its sales. The content of agreed-upon promotional messages for Altace(R) may not sufficiently convey the merits of Altace(R) and may not be successful in convincing physicians to prescribe Altace(R) instead of other angiotensin converting enzyme, or "ACE," inhibitors or competing therapies. The targets for sales force staffing, the number and frequency of details to physicians and the physicians who are called upon may be inadequate to realize our expectations for the revenues from Altace(R). Neither we nor American Home Products may be able to overcome the perception by physicians of a class effect, which we discuss below. Further, developments in technologies, the introduction of other products or new therapies may make it more attractive for American Home Products to concentrate on the promotion of a product or products other than Altace(R) or to lessen its emphasis on the marketing of Altace(R). Our strategic

decisions in dealing with managed health care organizations may not prove to be correct and we could consequently lose sales in this market to competing ACE inhibitor products or alternative therapies. If any of these situations occur, they could have a material adverse effect on our business, financial condition, results of operations and cash flows.

IF OUR BRISTOL FACILITY IS NOT QUALIFIED AS A MANUFACTURING AND PACKAGING SITE FOR ALTACE(R) OR IF THERE IS AN INTERRUPTION IN THE SUPPLY OF RAW MATERIAL FOR ALTACE(R), THE DISTRIBUTION, MARKETING AND SUBSEQUENT SALES OF THE PRODUCT COULD BE ADVERSELY AFFECTED.

We are currently working to qualify our Bristol facility as a manufacturing and packaging site for Altace(R). While Aventis Pharmaceuticals, Inc. (USA), successor to Hoechst Marion Roussel, Inc. from which we purchased Altace(R), will remain as a supplier of the finished Altace(R) product to us, we intend our Bristol facility to ultimately be the primary source for the manufacture and packaging of Altace(R) for us. If we are unable to secure the approval of our Bristol facility as a manufacturing and packaging site or do not do so in a timely manner, we may not be able to meet the anticipated demand for Altace(R). While Aventis (USA) will remain an alternative or back-up supplier of Altace(R), if we encounter delays or difficulties with the approval of our Bristol facility as a site for the manufacture and packaging of Altace(R), the distribution, marketing and subsequent sales of Altace(R) nonetheless could be adversely affected. If we are delayed or unsuccessful in securing approval of the Bristol facility as a supplier, we might not be able to make alternative supply arrangements for additional amounts of the finished product at commercially reasonable rates, if at all.

When we have qualified our Bristol facility as a manufacturing and packaging site for Altace(R), Aventis Pharma Deutscheland GmbH (Germany) will continue to be our single supplier of ramipril, the active ingredient in Altace(R). Because the manufacture of ramipril is a patented process, we cannot

secure the raw material from another source. Aventis (USA) currently manufactures and packages Altace(R) for us for sales in the United States and for itself for distribution outside of the United States. Any interruptions or delays in receiving the finished product or raw material used for the future production of Altace(R) could have a material adverse effect on our business, financial condition, results of operations and cash flows. We have entered into a supply agreement with Aventis (Germany) and we believe that it adequately protects our supply of raw material, but there can be no guarantee that there will not be interruptions or delays in the supply of the raw material.

SALES OF ALTACE(R) MAY BE AFFECTED BY THE PERCEPTION OF A CLASS EFFECT, AND ALTACE(R) AND OUR OTHER PRODUCTS MAY BE SUBJECT TO VARIOUS SOURCES OF COMPETITION FROM ALTERNATE THERAPIES.

Although the FDA has approved new indications for Altace(R), we may be unable to meet investors' expectations regarding sales of Altace(R) due to a perceived class effect or the inability to market Altace(R)'s new uses and indications effectively.

All prescription drugs currently marketed by pharmaceutical companies may be grouped into existing drug classes, but the criteria for inclusion vary from class to class. For some classes, specific biochemical properties may be the defining characteristic. For example, Altace(R) (ramipril) is a member of a class of products known as ACE inhibitors because ramipril is one of several chemicals that inhibits the production of enzymes that convert angiotensin, which could otherwise lead to hypertension.

When one drug from a class is demonstrated to have a particularly beneficial or previously undemonstrated effect (e.g., the benefit of Altace(R) as shown by the Heart Outcomes Prevention Evaluation, which we refer to as the "HOPE trial"), marketers of other drugs in the same class (for example, other ACE inhibitors) will represent that their products offer the same benefit simply by virtue of membership in the same drug class. Consequently, other companies with ACE inhibitors that compete with Altace(R) will represent that their products are equivalent to Altace(R). By doing so, these companies will represent that their products offer the same efficacious results demonstrated by the HOPE trial. Regulatory agencies do not decide whether products within a class are quantitatively equivalent in terms of efficacy or safety. Because comparative data among products in the same drug class are rare, marketing forces often dictate a physician's decision to use one ACE inhibitor over another. We may not be able to overcome other companies' representations that their ACE

inhibitors will offer the same benefits as Altace(R) as demonstrated by the HOPE trial. As a result, sales of Altace(R) may suffer from the perception of a class effect.

Currently, there is no generic form of Altace(R) available. That is, there is no product that has the same active ingredient as Altace(R). Although no generic substitute for Altace(R) has been approved by the FDA, there are other ACE inhibitors whose patents have expired or will expire in the next few years and there are generic forms of other ACE inhibitors. Also, there are different therapeutic agents that may be used to treat certain conditions treated by Altace(R). For example, the group of products known as beta-blockers, calcium channel blockers and diuretics, may be prescribed to treat certain conditions that Altace(R) is used to treat. New ACE inhibitors, increased sales of generic forms of other ACE inhibitors or of other therapeutic agents that compete with Altace(R) may adversely affect the sales of Altace(R).

OUR MARKETING ALLIANCE WITH AMERICAN HOME PRODUCTS FOR ALTACE(R) COULD BE TERMINATED BEFORE WE REALIZE ALL OF THE BENEFITS OF THE AGREEMENT OR IT COULD BE ASSIGNED TO ANOTHER COMPANY BY AMERICAN HOME PRODUCTS OR AMERICAN HOME PRODUCTS COULD MARKET A COMPETING PRODUCT.

Our exclusive Co-Promotion Agreement for Altace(R) with Wyeth-Ayerst Laboratories, a division of American Home Products Corporation, could be terminated before we realize all of the benefits of the agreement. American Home Products and we each have the right to terminate the agreement if annualized net sales of Altace(R) have not reached $300.0 million by October 4, 2003. There are other reasons why either American Home Products or we could terminate the Co-Promotion Agreement. If the Co-Promotion Agreement is terminated for any reason, we may not realize increased sales which we believe may result from the expanded promotion of Altace(R). If we must unwind our marketing alliance efforts because of the reasons mentioned above, there may be a material adverse effect on the sales of Altace(R).

If another company were to acquire, directly or indirectly, over 50% of the combined voting power of American Home Products' voting securities or more than half of its total assets, then American Home Products could assign its rights and obligations under the Altace(R) Co-Promotion Agreement to a successor without our prior consent. However, a successor would be required to first assume in writing the obligations of American Home Products under the Co-Promotion Agreement before the rights of American Home Products were assigned to it. Another party might not market Altace(R) as effectively or efficiently as American Home Products did. Also, a company which acquires American Home Products might not place as much emphasis on the Co-Promotion Agreement, might expend fewer marketing resources, such as a fewer number of sales representatives, than American Home Products did, or might have less experience or expertise in marketing pharmaceutical products to physicians. In any of these cases, there may be a material adverse effect on the sales of Altace(R).

When feasible, American Home Products must give us six months' written notice of its intent to sell, market or distribute any product competitive with Altace(R). Under the Co-Promotion Agreement, a product competes with Altace(R) if it is an ACE inhibitor, an angiotensin II receptor blocker, which we refer to as an "ARB," or an ACE inhibitor or ARB in combination with other cardiovascular agents in a single product. However, an ARB alone or in combination with other cardiovascular agents competes with Altace(R) only if the level of promotional effort used by American Home Products for the ARB is greater than 50% of that applied to Altace(R). A product would not compete with Altace(R) if in the last 12 months it had net sales of less than $100.0 million or 15% of net sales of Altace(R), whichever was higher. Also, a product would not compete with Altace(R) under the Co-Promotion Agreement if the product were acquired by American Home Products through a merger with or acquisition by a third party and the product was no longer actively promoted by American Home Products or its successor through detailing the product to physicians.

Once we have been notified in writing of American Home Products' intent to market, sell or distribute a competing product, then American Home Products has 90 days to inform us as to whether it intends to divest its interest in the competing product. If American Home Products elects to divest the competing product, it must try to identify a purchaser and to enter into a definitive agreement with the purchaser as soon as practicable. If American Home Products elects not to divest the competing product or fails to divest the product within one year of providing notice to us of its plan to divest the competing product, then both of us

must attempt to establish acceptable terms under which we would together market

the competing product for the remaining term of our Altace(R) Co-Promotion Agreement. Alternatively, American Home Products and we could agree upon another commercial relationship, such as royalties payable to us for the sale of the competing product, or we could agree to adjust the promotion fee we pay to American Home Products for the marketing of Altace(R). If American Home Products and we are unable to establish acceptable terms under any of these options, then we have the option at our sole discretion to reacquire all the marketing rights to Altace(R) and terminate the Co-Promotion Agreement upon 180 days' prior written notice to American Home Products. In the event we decided to reacquire all the marketing rights to Altace(R) we would be obligated to pay American Home Products an amount of cash equal to twice the net sales of Altace(R) in the United States for the 12 month period preceding the reacquisition. Such a decision could have a material effect on our business, financial condition, the results of our operations and cash flows.

OUR SALES OF LEVOXYL(R) COULD BE AFFECTED BY FUTURE ACTIONS OF THE FDA AND BY UNCERTAINTY IN THE LEVOTHYROXINE SODIUM PRODUCT MARKET.

On August 14, 1997, the FDA announced in the Federal Register (62 FR 43535) that orally administered levothyroxine sodium drug products are new drugs. The notice stated that manufacturers who wish to continue to market these products must submit applications as required by the Food, Drug and Cosmetic Act, or "FDC Act," as it is generally known, by August 14, 2000. On April 26, 2000, the FDA issued a second Federal Register notice extending the deadline for filing these applications until August 14, 2001.

On May 25, 2001, the FDA approved our previously filed New Drug Application for Levoxyl(R), our levothyroxine sodium drug product. Other manufacturers of levothyroxine sodium drug products have filed New Drug Applications for their levothyroxine sodium products. Jerome Stevens, Inc. has also received approval for its levothyroxine sodium product Unithroid. After August 14, 2001, the FDA will refuse to accept a New Drug Application for a levothyroxine sodium drug product that is pharmaceutically equivalent to an approved product. However, the FDA has stated it will continue to review applications which were submitted by August 14, 2001. Further, the FDA is requiring a phasing-out of the distribution of levothyroxine sodium products for which New Drug Applications were pending but not approved by August 14, 2001. Other manufacturers who wish to submit an application for an equivalent product after August 14, 2001 must submit an Abbreviated New Drug Application. Also, since the Jerome Stevens product has been approved, a manufacturer could submit an Abbreviated New Drug Application demonstrating in vivo bioequivalence (in other words, the two products produce identical effects on the body) to the Jerome Stevens product. If the FDA were to determine that another levothyroxine sodium product is bioequivalent to Levoxyl(R), generic substitution for Levoxyl(R) may become possible which could result in a decrease in sales of our product Levoxyl(R).

WE CANNOT ASSURE YOU THAT SALES OF LORABID(R) WILL INCREASE IN THE FUTURE. IF SALES DO NOT INCREASE, THERE MAY BE A MATERIAL ADVERSE EFFECT UPON OUR RESULTS OF OPERATIONS.

Prior to our acquisition of Lorabid(R), sales of that product were on the decline because we believe that the prior owner was not actively promoting the product. Increased sales of Lorabid(R) depend upon effective marketing to physicians which leads them to write prescriptions for our product. Since the antibiotic market is very competitive, we cannot assure you that sales of Lorabid(R) will increase in the future. If Lorabid(R) sales do not increase or if they continue to decrease, there may be a material adverse effect upon our results of operations and cash flow.

IF WE CANNOT IMPLEMENT OUR STRATEGY TO GROW OUR BUSINESS THROUGH INCREASED SALES AND ACQUISITIONS, OUR COMPETITIVE POSITION IN THE PHARMACEUTICAL INDUSTRY MAY SUFFER.

We have historically increased our sales and net income through strategic acquisitions and related internal growth initiatives intended to develop marketing opportunities with respect to acquired product lines. Our strategy is focused on increasing sales and enhancing our competitive standing through acquisitions that complement our business and enable us to promote and sell new products through existing marketing and

distribution channels. Moreover, since we engage in limited proprietary research activity with respect to product development, we rely heavily on purchasing product lines from other companies.

Other companies, many of which have substantially greater financial, marketing and sales resources than we do, may compete with us for the acquisition of products or companies. We may not be able to acquire rights to additional products or companies on acceptable terms, if at all, or be able to obtain future financing for acquisitions on acceptable terms, if at all. The inability to effect acquisitions of additional branded products could limit the overall growth of our business. Furthermore, even if we obtain rights to a pharmaceutical product or acquire a company, we may not be able to generate sales sufficient to create a profit or otherwise avoid a loss. For example, our marketing strategy, distribution channels and levels of competition with respect to acquired products may be different than those of our current products, limiting our ability to compete favorably in those product categories.

IF WE CANNOT INTEGRATE THE BUSINESS OF COMPANIES OR PRODUCTS WE ACQUIRE, OUR BUSINESS MAY SUFFER.

We anticipate that the integration of newly acquired companies and products into our business will require significant management attention and expansion of our sales force. In order to manage our acquisitions effectively, we must maintain adequate operational, financial and management information systems and motivate and effectively manage an increasing number of employees. Our recent acquisitions, including the acquisition of Jones Pharma Incorporated, have significantly expanded our product offerings, operations and number of employees. Our future success will also depend in part on our ability to retain or hire qualified employees to operate our expanding facilities efficiently in accordance with applicable regulatory standards. If we cannot integrate our acquisitions successfully, these changes and acquisitions could have a material adverse effect on our business, financial condition, results of operations and cash flows.

IF WE ARE NOT ABLE TO DEVELOP OR LICENSE NEW PRODUCTS, OUR BUSINESS MAY SUFFER.

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

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

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

- develop or license new products in a cost effective manner.

For example, we are

- engaged in the development of binodisine (MRE0470), a myocardial

pharmacologic stress imaging agent;

- in a licensing agreement with Novavax to develop recombinant human papillomavirus (HPV) virus-like particle (VLP) vaccines; and

- in exclusive license agreements with Novavax to promote, market, distribute and sell Estrasorb(TM), a topical transdermal estrogen replacement therapy, and Androsorb(TM), a topical testosterone replacement therapy for testosterone deficient women, upon their approval by the FDA.

However, we cannot assure you that we will be successful in any or all of these projects.

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

- develop or license their products more rapidly than we can,

- complete any applicable regulatory approval process sooner than we can,

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

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

and thereby have a negative impact on the sales of our newly developed or licensed products. Technological developments or the FDA's approval of new therapeutic indications for existing products may make our existing products or those products we are licensing or developing obsolete or may make them more difficult to market successfully, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

WE DO NOT HAVE PROPRIETARY PROTECTION FOR MOST OF OUR BRANDED PHARMACEUTICAL PRODUCTS, AND OUR SALES COULD SUFFER FROM COMPETITION BY GENERIC SUBSTITUTES.

Although most of our revenue is generated by products not subject to competition from generic products, there is no proprietary protection for most of our branded pharmaceutical products, and generic substitutes for most of these products are sold by other pharmaceutical companies. In addition, governmental and other pressure to reduce pharmaceutical costs may result in physicians prescribing products for which there are generic substitutes. Increased competition from the sale of generic pharmaceutical products may cause a decrease in revenue from our branded products and could have a material adverse effect on our business, financial condition and results of operations. In addition, our branded products for which there is no generic form available may face competition from different therapeutic agents used for the same indications for which our branded products are used.

THIRD PARTIES MANUFACTURE OR SUPPLY MATERIALS FOR MANY OF OUR PRODUCTS, AND ANY DELAYS OR DIFFICULTIES EXPERIENCED BY THEM MAY REDUCE OUR PROFIT MARGINS AND REVENUES OR HARM OUR REPUTATION.

Many of our product lines, including Altace(R), Lorabid(R) and Cortisporin(R), are currently manufactured by third parties. Our dependence upon third parties for the manufacture of our products may adversely impact our

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

We require a supply of quality raw materials and components to manufacture and package pharmaceutical products for us and for third parties with which we have contracted. Generally, we have not had difficulty obtaining raw materials and components from suppliers in the past. Currently, we rely on over 500 suppliers to deliver the necessary raw materials and components. We have no reason to believe that we will be unable to procure adequate supplies of raw materials and components on a timely basis. However, if we are unable to obtain sufficient quantities of any of the raw materials or components required to produce and package our products, we may not be able to distribute our products as planned. In this case, our business, financial condition and results of operations could be materially and adversely affected.

OUR PARKEDALE FACILITY HAS BEEN THE SUBJECT OF FDA CONCERNS. IF WE CANNOT ADEQUATELY ADDRESS THE FDA'S CONCERNS, WE MAY BE UNABLE TO OPERATE THE PARKEDALE FACILITY AND, ACCORDINGLY, OUR BUSINESS MAY SUFFER.

Our Parkedale facility, located in Rochester, Michigan, manufactures both drug and biological pharmaceutical products. Prior to our acquisition of the Parkedale facility in February 1998, it was one of six Pfizer facilities subject to a consent decree issued by the U.S. District Court of New Jersey in August 1993 as a result of FDA concerns about compliance issues within Pfizer facilities in the period before the decree was entered.

The Parkedale facility was inspected by the FDA in February 2001. When an FDA inspector completes an authorized inspection of a manufacturing facility, the FDC Act mandates that the inspector give to the owner/operator of the facility a written report listing the inspector's observations of objectionable conditions and practices. This written report is known as an "FDA Form 483" or simply as a "483." The observations in a 483 are reported to the manufacturer in order to assist the manufacturer in complying with the FDC Act and the regulations enforced by the FDA. Often a pharmaceutical manufacturer receives a 483 after an inspection and our Parkedale facility received a 483 following the February 2001 inspection. While no law or regulation requires us to respond to a 483, we have submitted a written response detailing our plan of action with respect to each of the observations made on the February 483 and our commitment to correct the objectionable practice or condition. The risk to us of a 483, if left uncorrected, could include, among other things, the imposition of civil monetary penalties, the commencement of actions to seize or prohibit the sale of unapproved or non-complying products, or the cessation of manufacturing operations at the Parkedale facility that are not in compliance with current Good Manufacturing Practices, generally known as "cGMP." While we believe the receipt of the 483 will not have a material adverse effect on our business, financial condition, results of operation and cash flows, we cannot assure you that future inspections may not result in adverse regulatory actions. The 483 from February 2001 does not require us to delay or discontinue the production of any products made at the Parkedale facility.

AN INCREASE IN PRODUCT LIABILITY CLAIMS, PRODUCT RECALLS OR PRODUCT RETURNS COULD HARM OUR BUSINESS.

We face an inherent business risk of exposure to product liability claims in the event that the use of our technologies or products are alleged to have resulted in adverse effects. These risks will exist for those products in clinical development and with respect to those products that receive regulatory approval for commercial sale. While we have taken, and will continue to take, what we believe are appropriate precautions, we may not be able to avoid significant product liability exposure. We currently have product liability insurance in the amount of $75.0 million for aggregate annual claims with a $50,000 deductible per incident and a $500,000 aggregate annual deductible; however, we cannot assure you that the level or breadth of any insurance coverage will be sufficient to cover fully all potential claims. Also, adequate insurance coverage might not be available in the future at acceptable costs, if at all.

Product recalls may be issued at our discretion, at the discretion of the FDA, or at the discretion of other government agencies or other companies having regulatory authority for pharmaceutical product sales. From time to time, we may recall products for various reasons. To date, however, these recalls have not been significant and have not had a material adverse effect on our business, financial condition, results of operations and cash flows. However, we cannot assure you that the number and significance of recalls will not increase in the future.

Although product returns were approximately 2.4% of gross sales for the year ended December 31, 2000, we cannot assure you that actual levels of returns will not increase or significantly exceed the amounts we have anticipated.

OUR WHOLLY OWNED SUBSIDIARY, JONES PHARMA, IS A DEFENDANT IN LITIGATION WHICH IS CURRENTLY BEING HANDLED BY ITS INSURANCE CARRIERS. SHOULD THIS COVERAGE BE INADEQUATE OR SUBSEQUENTLY DENIED OR WERE WE TO LOSE SOME OF THESE LAWSUITS, OUR RESULTS OF OPERATIONS COULD BE ADVERSELY AFFECTED.

Our wholly owned subsidiary, Jones Pharma, is a defendant in more than 1,800 multi-defendant lawsuits involving the manufacture and sale of dexfenfluramine, fenfluramine and phentermine, which is usually referred to as "fen/phen." In 1996 Jones acted as a distributor of Obenix(R), a branded phentermine product. Jones also distributed a generic phentermine product. Jones believes that its phentermine products have been identified in less than 100 of the foregoing cases. The plaintiffs in these cases claim injury as a result of ingesting a combination of these weight-loss drugs. They seek compensatory and punitive damages as well as medical care and court-supervised medical monitoring. The plaintiffs claim liability based on a variety of theories including but not limited to, product liability, strict liability, negligence, breach of warranties and misrepresentation. These suits are filed in various jurisdictions throughout the United States, and in each of these suits Jones is one of many defendants, including manufacturers and other distributors of these drugs.

Jones denies any liability incident to the distribution of its phentermine product and intends to pursue all defenses available to it. Jones has tendered defense of these lawsuits to its insurance carriers for handling and they are currently defending Jones in these suits. In the event that insurance coverage is inadequate to satisfy any resulting liability, Jones will have to resume defense of these lawsuits and be responsible for the damages, if any, that are awarded against it.

SALES OF THROMBIN-JMI(R) MAY BE AFFECTED BY THE PERCEPTION OF RISKS ASSOCIATED WITH SOME OF THE RAW MATERIALS USED IN ITS MANUFACTURE.

The source material for our product Thrombin-JMI(R) comes from bovine plasma and lung tissue. Bovine-sourced materials from outside the United States may be of some concern because of potential transmission of Bovine Spongiform Encephalopathy, or BSE. However, we have taken precautions to minimize the risks of contamination from BSE in our source materials including, primarily, the use of bovine materials only from FDA-approved sources in the United States. Although no BSE has been documented in the United States, the United States is considered a Category II BSE-risk country, meaning that the United States is probably BSE-free but has some history of importing cattle from the United Kingdom.

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

THE LOSS OF OUR KEY PERSONNEL COULD HARM OUR BUSINESS.

We are highly dependent on the principal members of our management staff, the loss of whose services might impede the achievement of our acquisition and development objectives. Although we believe that we are adequately staffed in key positions and that we will be successful in retaining skilled and experienced management, operational, scientific and development personnel, we cannot assure you that we will be able to attract and retain key personnel on acceptable terms. The loss of the services of key personnel could have a material adverse effect on us, especially in light of our recent growth. We do not maintain key-person life insurance on any of our employees. In addition, we do not have employment agreements with any of our key employees.

IF WE ARE UNABLE TO SECURE OR ENFORCE PATENT RIGHTS, TRADEMARKS, TRADE SECRETS OR OTHER INTELLECTUAL PROPERTY, OUR BUSINESS COULD BE HARMED.

We may not be successful in securing or maintaining proprietary patent protection for products we develop or technologies we license. In addition, our competitors may develop products similar to ours using methods and technologies that are beyond the scope of our intellectual property protection, which could reduce our sales. The validity of patents can be subject to expensive litigation. We can give you no assurance that our patents will not be challenged. Competitors may be able to develop similar or competitive products outside the scope of our patents which could have a material adverse effect on sales of our products or the amounts of royalty revenues we receive.

We also rely upon trade secrets, unpatented proprietary know-how and continuing technological innovation, where patent protection is not believed to be appropriate or attainable, in order to maintain our

competitive position. We cannot assure you that others will not independently develop substantially equivalent proprietary technology and techniques or otherwise gain access to our trade secrets or disclose the technology, or that we can adequately protect our trade secrets.

OUR SHAREHOLDER RIGHTS PLAN AND BYLAWS DISCOURAGE UNSOLICITED TAKEOVER PROPOSALS AND COULD ENTRENCH CURRENT MANAGEMENT AND PREVENT SHAREHOLDERS FROM REALIZING A PREMIUM ON THEIR COMMON STOCK.

We have a shareholder rights plan that may have the effect of discouraging unsolicited takeover proposals, thereby entrenching current management and possibly depressing the market price of our common stock. The rights issued under the shareholder rights plan would cause substantial dilution to a person or group which attempts to acquire us on terms not approved in advance by our board of directors. In addition, our charter and bylaws contain provisions that may discourage unsolicited takeover proposals that shareholders may consider to be in their best interests. These provisions include:

- a classified board of directors,
- the ability of the board of directors to designate the terms of and issue new series of preferred stock,
- advance notice requirements for nominations for election to the board of directors, and
- special voting requirements for the amendment of our charter and bylaws.

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

RISKS RELATED TO OUR INDUSTRY

FAILURE TO COMPLY WITH GOVERNMENT REGULATIONS COULD AFFECT OUR ABILITY TO OPERATE OUR BUSINESS.

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

Noncompliance with applicable FDA policies or requirements could subject us to enforcement actions, such as suspensions of manufacturing or distribution, seizure of products, product recalls, fines, criminal penalties, injunctions, failure to approve pending drug product applications or withdrawal of product marketing approvals. Similar civil or criminal penalties could be imposed by other government agencies, such as the DEA, the EPA or various agencies of the states and localities in which our products are manufactured, sold or distributed and could have ramifications for our contracts with government agencies such as the Veteran's Administration or the Department of Defense.

These enforcement actions could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

new legislation, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

ANY REDUCTION IN REIMBURSEMENT LEVELS BY MANAGED CARE ORGANIZATIONS OR OTHER THIRD-PARTY PAYORS MAY HAVE AN ADVERSE EFFECT ON OUR REVENUES.

Commercial success in producing, marketing and selling products depends, in part, on the availability of adequate reimbursement from third-party health care payors, such as government and private health insurers and managed care organizations. Third-party payors are increasingly challenging the pricing of medical products and services. For example, many managed health care organizations are now controlling the pharmaceutical products that are on their formulary lists. The resulting competition among pharmaceutical companies to place their products on these formulary lists has reduced prices across the industry. In addition, many managed care organizations are considering formulary contracts primarily with those pharmaceutical companies that can offer a full line of products for a given therapy sector or disease state. We cannot assure you that our products will be included on the formulary lists of managed care organizations or that downward pricing pressures in the industry generally will not negatively impact our operations.

NEW LEGISLATION OR REGULATORY PROPOSALS MAY ADVERSELY AFFECT OUR ABILITY TO RAISE CAPITAL AND OUR REVENUES.

A number of legislative and regulatory proposals aimed at changing the health care system, including the cost of prescription products, reimportation of prescription products and changes in the levels at which

pharmaceutical companies are reimbursed for sales of their products, have been proposed. While we cannot predict when or whether any of these proposals will be adopted or the effect these proposals may have on our business, the pending nature of these proposals, as well as the adoption of any proposal, may harm our ability to raise capital, may exacerbate industry-wide pricing pressures and could have a material adverse effect on our financial condition, results of operations or cash flows.

THE INDUSTRY IS HIGHLY COMPETITIVE, AND OTHER COMPANIES IN OUR INDUSTRY HAVE MUCH GREATER RESOURCES THAN WE DO.

In the industry, comparatively smaller pharmaceutical companies like us compete with large, global pharmaceutical companies with substantially greater financial resources for the acquisition of products, technologies and companies.

COMPETITION FOR ACQUISITIONS. We compete with other pharmaceutical companies for product and product line acquisitions. These competitors include Forest Laboratories, Inc., Shire Pharmaceuticals Group plc, Biovail Corporation, Watson Pharmaceuticals, Inc., Medicis Pharmaceutical Corporation and other companies which also acquire branded pharmaceutical products and product lines from other pharmaceutical companies. We cannot assure you that

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

PRODUCT COMPETITION. Additionally, since our products are generally established and commonly sold, they are subject to competition from products with similar qualities.

Our largest product Altace(R) competes in the market with other cardiovascular therapies, including in particular, the following ACE inhibitors:

- Zestril(R) (AstraZeneca PLC),

- Acupril(R) (Pfizer Inc.),

- Prinivil(R) (Merck & Co., Inc.),

- Lotensin(R) (Novartis AG), and

- Monopril(R) (Bristol-Meyers Squibb Company).

Our second largest product Levoxyl(R) competes with the following levothyroxine sodium products:

- Synthroid(R) (Abbott Laboratories),

- Levothroid(R) (Forest Laboratories, Inc.), and

- Unithroid(R) (Watson Pharmaceuticals, Inc.)

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

- detailing and sampling to the primary prescribing physician groups

- sponsoring physician symposiums, including continuing medical education seminars, and

- conducting a planned direct-to-consumer advertising campaign for Altace(R).

Our branded pharmaceutical products may be subject to competition from alternate therapies and from generic equivalents.

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

2000 the FDA approved for sale generic substitutes for Tapazole(R). Of our branded pharmaceutical products, based on a percentage of net revenues, we believe that only a small portion face significant generic competition because many of our branded pharmaceutical products are too difficult to manufacture or prove bioequivalence (i.e., the two products produce identical effects on the body) or have sales levels that are too low to attract competition.

The manufacturers of generic products typically do not bear the related research and development costs and, consequently, are able to offer such products at considerably lower prices than the branded equivalents. There are, however, a number of factors which enable products to remain profitable once patent protection has ceased. For a manufacturer to launch a generic substitute, it must prove to the FDA when filing an application to make a generic substitute that the branded pharmaceutical and the generic substitute have bioequivalence. We believe it typically takes two or three years to prove bioequivalence and receive FDA approval for many generic substitutes. By focusing our efforts in part on products with bioequivalence or complex manufacturing requirements and

products with a strong brand image with the prescriber or the consumer, supported by the development of a broader range of alternative product formulations or dosage forms, we are better able to protect market share and produce sustainable high margins and cash flows.

FORWARD-LOOKING STATEMENTS

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

These forward-looking statements are identified by their use of terms and phrases, such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "will" and similar terms and phrases, including references to assumptions. These statements are contained in sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business" in our Annual Report on Form 10-K/A for the year ended December 31, 2000 and in sections of this report, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" which includes a section entitled "Risk Factors".

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

- the future growth potential of, and prescription trends for our branded pharmaceutical products, particularly Altace(R), Levoxyl(R) and Thrombin-JMI(R);
- expected trends with respect to particular income and expense line items;
- the development and potential commercialization of HPV vaccines, Estrasorb(TM) and Androsorb(TM) by Novavax and King;
- the development by King Pharmaceuticals Research and Development of binodisine, pre-clinical programs, and product life cycle development projects;
- our continued successful execution of our growth strategies;
- anticipated developments and expansions of our business;
- increases in sales of recently acquired products or royalty payments;
- the success of existing co-promotion agreements;
- the high cost and uncertainty of research, clinical trials and other development activities involving pharmaceutical products;
- development of product line extensions;
- the unpredictability of the duration or future findings and determinations of the FDA and other regulatory agencies worldwide;

- debt service and leverage requirements;
- the products which we expect to offer;
- the intent to market and distribute certain of our products

internationally;

- the intent to manufacture certain products in our own facilities which are currently manufactured for us by third parties;

- the intent, belief or current expectations, primarily with respect to our future operating performance;

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

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

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from those contemplated by our forward-looking statements. These known and unknown risks, uncertainties and other factors are described in detail in the section entitled "Risk Factors" beginning on page 27.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

As of September 30, 2001, there were no significant changes in our qualitative or quantitative market risk since the prior reporting period.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this Item is incorporated by reference to Note 5 to the Condensed Consolidated Financial Statements included elsewhere in this document.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

We filed the following Current Reports on Form 8-K during the quarter ended September 30, 2001:

(1) A Current Report on Form 8-K filed July 23, 2001 furnished under Item 9 additional financial information pertaining to our four-for-three stock split declared by the board of directors on June 20, 2001 for shareholders of record as of July 3, 2001, and distributed on July 19, 2001.

(2) A Current Report on Form 8-K filed August 9, 2001, and amended August 24, 2001 and October 19, 2001 reported under Items 2 and 7 the Company's acquisition of three branded pharmaceutical products and a license to a fourth product from Bristol-Myers Squibb Company. The products

acquired include Bristol-Myers Squibb's rights in the United States to Corzide(R), Delestrogen(R), and Florinef(R). King also acquired a fully paid license to market Corgard(R) in the United States. Total consideration paid by King for the four branded pharmaceutical products equals $285 million. The acquisition was financed with a combination of borrowings under our senior secured credit facility and cash on hand.

SIGNATURES

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

KING PHARMACEUTICALS, INC.

Date: November 14, 2001

By: /s/ JOHN M. GREGORY

John M. Gregory
Chairman and Chief Executive Officer

Date: November 14, 2001

By: /s/ JAMES R. LATTANZI

James R. Lattanzi
Chief Financial Officer