ENDO PHARMACEUTICALS HOLDINGS INC
Form 10-Q
August 15, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 June 30, 2003

OR

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

For the transition period from _____ to _____.

Commission file number: 001-15989

ENDO PHARMACEUTICALS HOLDINGS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**13-4022871**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

100 Painters Drive
Chadds Ford, Pennsylvania 19317
(Address of Principal Executive Offices)

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

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

The aggregate number of shares of the Registrant s common stock outstanding as of August 14, 2003 was 131,760,476.

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ENDO PHARMACEUTICALS HOLDINGS INC.

REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

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Forward Looking Statements

We have made forward-looking statements in this document within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended. These statements, including estimates of future net sales and consolidated EBITDA contained in the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations, are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed results of operations. Also, statements including words such as believes, expects, anticipates, intends, estimates, or similar expressions are forward-looking statements. We have based these forward-looking statements on our current expectations and projections about the growth of our business, our financial performance and the development of our industry. Because these statements reflect our current views concerning future events, these forward-looking statements involve risks and uncertainties. Investors should note that many factors, as more fully described in Management s Discussion and Analysis of Financial Condition and Results of Operations, Business and elsewhere in this Report could affect our future financial results and could cause our actual results to differ materially from those expressed in forward-looking statements contained in this Report. Important factors that could cause our actual results to differ materially from the expectations reflected in the forward-looking statements in this Report include, among others:

- our ability to successfully develop, commercialize and market new products;
- results of clinical trials on new products;
- competition for the business of our branded and generic products, and in connection with our acquisition of rights to intellectual property assets;
- market acceptance of our future products;
- government regulation of the pharmaceutical industry;
- our dependence on a small number of products;
- our dependence on outside manufacturers for the manufacture of our products;
- our dependence on third parties to supply raw materials and to provide services for the core aspects of our business;
- new regulatory action or lawsuits relating to the use of narcotics in most of our core products;
- our exposure to product liability claims and product recalls and the possibility that we may not be able to adequately insure ourselves;
- our ability to protect our proprietary technology;
- our ability to successfully implement our acquisition strategy;
- the availability of controlled substances that constitute the active ingredients of some of our products and products in development;
- the availability of third-party reimbursement for our products; and
- our dependence on sales to a limited number of large pharmacy chains and wholesale drug distributors for a large portion of our total net sales.

We do not undertake any obligation to update our forward-looking statements after the date of this Report for any reason, even if new information becomes available or other events occur in the future.

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PART I

FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ENDO PHARMACEUTICALS HOLDINGS INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(In thousands, except share data)

	June 30, 2003	December 31, 2002
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 168,474	$ 56,902
Accounts receivable, net	119,417	119,496
Inventories	39,696	35,516
Prepaid expenses	4,839	4,354
Deferred income taxes	59,802	41,219
Total current assets	392,228	257,487
PROPERTY AND EQUIPMENT, Net	12,707	11,810
GOODWILL	181,079	181,079
OTHER INTANGIBLES, Net	35,649	36,755
DEFERRED INCOME TAXES	21,585	21,184
OTHER ASSETS	5,041	4,657
TOTAL ASSETS	$ 648,289	$ 512,972
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 57,447	$ 75,443
Accrued expenses	94,455	68,627
Income taxes payable	25,524	8,359
Total current liabilities	177,426	152,429
OTHER LIABILITIES	7,734	7,851
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred Stock, $.01 par value; 40,000,000 shares authorized; none issued		
Common Stock, $.01 par value; 175,000,000 shares authorized; 131,758,861 and 102,064,450 issued and outstanding at June 30, 2003 and December 31, 2002, respectively	1,318	1,021
Additional paid-in capital	595,500	547,249
Accumulated deficit	(132,875)	(194,402)
Accumulated other comprehensive loss	(814)	(1,176)

Total Stockholders Equity	463,129	352,692
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 648,289	$ 512,972

See Notes to Consolidated Financial Statements

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ENDO PHARMACEUTICALS HOLDINGS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
NET SALES	$152,027	$107,902	$304,301	$174,928
COST OF SALES	26,258	27,805	53,835	46,696
GROSS PROFIT	125,769	80,097	250,466	128,232
COSTS AND EXPENSES:				
Selling, general and administrative	41,801	27,562	77,917	51,145
Research and development	9,438	15,142	21,502	28,538
Depreciation and amortization	1,365	691	2,717	1,476
Compensation related to stock options Primarily selling, general and administrative			48,514	
OPERATING INCOME	73,165	36,702	99,816	47,073
INTEREST EXPENSE, Net of interest income of $196, $341, $287 and $648, respectively	22	1,649	153	3,271
INCOME BEFORE INCOME TAX	73,143	35,053	99,663	43,802
INCOME TAX	27,975	13,052	38,136	16,425
NET INCOME	$ 45,168	$ 22,001	$ 61,527	$ 27,377
NET INCOME PER SHARE:				
Basic	$ .34	$ .22	$ .49	$ .27
Diluted	$ .34	$ .22	$ .46	$ .27
WEIGHTED AVERAGE SHARES:				
Basic	131,734	102,064	125,014	102,064
Diluted	132,667	102,271	132,419	102,276

See Notes to Consolidated Financial Statements.

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ENDO PHARMACEUTICALS HOLDINGS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Six Months Ended June 30,	
	2003	**2002**
OPERATING ACTIVITIES:		
Net Income	$ 61,527	$ 27,377
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,717	1,476
Amortization of deferred financing costs	199	191
Accretion of promissory notes		3,448
Deferred income taxes	(19,207)	(1,847)
Compensation related to stock options	48,514	
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable	79	(28,533)
Inventories	(4,180)	(1,295)
Other assets	(476)	2,190
Accounts payable	7,004	5,150
Accrued expenses	25,780	41,770
Income taxes payable	17,165	14,094
Other liabilities		10
Net cash provided by operating activities	139,122	64,031
INVESTING ACTIVITIES:		
Purchase of property and equipment	(2,309)	(827)
License fees	(25,000)	
Net cash used in investing activities	(27,309)	(827)
FINANCING ACTIVITIES:		
Capital lease obligations repayments	(277)	
Exercise of pre-merger Endo warrants	2	
Exercise of Endo Pharmaceuticals Holdings Inc. stock options	34	4
Repurchase of Class A Transferable and Class B Non-Transferable Warrants		(6,730)
Net cash used in financing activities	(241)	(6,726)
NET INCREASE IN CASH AND CASH EQUIVALENTS	111,572	56,478
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	56,902	95,357
CASH AND CASH EQUIVALENTS, END OF PERIOD	$168,474	$151,835
SUPPLEMENTAL INFORMATION:		
Interest Paid	$ 191	$ 134
Income Taxes Paid	$ 39,884	$ 4,180

See Notes to Consolidated Financial Statements.

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ENDO PHARMACEUTICALS HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FOR THE SIX MONTHS ENDED JUNE 30, 2003

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the accompanying condensed consolidated financial statements of Endo Pharmaceuticals Holdings Inc. (the Company or we) and its subsidiaries, which are unaudited, include all normal and recurring adjustments necessary to present fairly the Company s financial position as of June 30, 2003 and the results of operations and cash flows for the periods presented. The accompanying consolidated balance sheet as of December 31, 2002 is derived from the Company s audited financial statements. Certain information and footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted as promulgated by Accounting Principles Board Opinion No. 28 and Rule 10.01 of Regulation S-X under the Securities Act of 1933. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto as of and for the year ended December 31, 2002 contained in the Company s Annual Report on Form 10-K. Certain reclassifications have been made to the prior period s financial statements to conform with the classifications used in 2003.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In January 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. We adopted the provisions of SFAS No. 144 on January 1, 2002, which had no material impact on our results of operations or financial position.

In June 2001, the FASB, issued SFAS No. 141, *Business Combinations,* and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 was effective for all business combinations completed after June 30, 2001. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that all business combinations be accounted for under the purchase method only and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS No. 142 establishes revised reporting requirements for goodwill and other intangible assets. See Note 3 to the Consolidated Financial Statements.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS No. 145 (1) rescinds SFAS No. 4 and SFAS No. 64, which relate to the extinguishment of debt, (2) rescinds No. 44 relating to the accounting for intangible assets of motor carriers, and (3) amends SFAS No. 13 relating to the accounting for leases. SFAS No. 145 also amends certain other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. Certain amounts were reclassified in accordance with SFAS No. 145 in the accompanying financial statements. We believe that the adoption of SFAS No. 145 will not have material impact on our results of operations or financial position.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires recognition of a liability for a cost associated with an exit or disposal activity when the liability is incurred, as opposed to when the entity commits to an exit plan under previous guidance. This statement is effective for exit or disposal activities initiated after December 31, 2002. We believe that the adoption of SFAS No. 146 will not have a material impact on our results of operations or financial position.

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that upon issuance of certain guarantees, a guarantor must recognize a liability for the fair value of an obligation assumed under the guarantee. FIN 45 also requires significant new disclosures, in both interim and annual financial statements, by a guarantor, about obligations associated with guarantees issued. FIN 45 disclosure requirements were effective for our fiscal year ended December 31, 2002 and the initial recognition and measurement provisions are

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applicable on a prospective basis to guarantees issued or modified after December 31, 2002. At June 30, 2003, we had no guarantees outstanding.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have not adopted the fair value based method of accounting for employee stock-based compensation.

3. GOODWILL AND OTHER INTANGIBLES

Effective January 1, 2002, we adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, and will no longer amortize goodwill and workforce in place.

Our goodwill and other intangible assets consist of the following (in thousands):

	June 30, 2003	December 31, 2002
Goodwill	$181,079	$181,079
Amortizable Intangibles:		
Licenses	$ 36,000	$ 36,000
Patents	3,200	3,200
	39,200	39,200
Less accumulated amortization	(3,551)	(2,445)
Other Intangibles, net	$ 35,649	$ 36,755

Goodwill and other intangibles represents a significant portion of our assets and stockholders equity. As of June 30, 2003, goodwill and other intangibles comprised approximately 33% of our total assets and 47% of our stockholders equity. We assess the potential impairment of goodwill by comparing the fair value of goodwill to its carrying value for our one reporting unit. An impairment loss would be recognized when the estimated fair value is less than its carrying amount. As a result of the significance of goodwill, our results of operations and financial position in a future period could be negatively impacted should an impairment of goodwill occur.

We have one reportable segment, pharmaceutical products. Goodwill arose as a result of the August 26, 1997 acquisition of certain branded and generic pharmaceutical products, related rights and certain assets of the then DuPont Merck Pharmaceutical Company (n/k/a Bristol-Myers Squibb Pharma Company) and the July 17, 2000 acquisition of Algos Pharmaceutical Corporation. Although goodwill arose in two separate transactions, the components of our operating segment have been integrated and are managed as one reporting unit. Our components extensively share assets and other resources with the other components of our business and have similar economic characteristics. In addition, our components do not maintain discrete financial information. Accordingly, the components of our business have been aggregated into one reporting unit and are evaluated as such for goodwill impairment. Goodwill is evaluated for impairment on an annual basis on January 1st of each year unless events or circumstances indicate that an impairment may have occurred between annual dates. Goodwill has been evaluated for impairment upon the adoption of SFAS No. 142 on January 1, 2002 and, based on the fair value of our reporting unit at such time, no impairment has been identified. On January 1, 2003, our goodwill was evaluated for impairment and, based on the fair value of our reporting unit at such time, no impairment was identified.

Effective January 1, 2002, we reclassified the carrying amount of workforce-in-place as goodwill. The cost of license fees is capitalized and is being amortized using the straight-line method over the licenses estimated useful lives of seventeen to twenty years. The cost of acquired patents is capitalized and is being amortized using the straight-line method over their estimated useful lives of seventeen years.

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Estimated amortization of intangibles for the five fiscal years subsequent to December 31, 2002 is as follows (in thousands):

2003	$2,212
2004	2,212
2005	2,212
2006	2,212
2007	2,212

4. COMPENSATION RELATED TO STOCK OPTIONS

Endo Pharma LLC 1997 Executive and Employee Stock Option Plans

On November 25, 1997, the Company established the 1997 Employee Stock Option Plan and the 1997 Executive Stock Option Plan (collectively, the 1997 Stock Option Plans). Pursuant to the recapitalization of the Company on July 17, 2000 (which took place in connection with the acquisition of Algos Pharmaceutical Corporation), the 1997 Stock Option Plans were amended and restated. The Endo Pharma LLC 1997 Stock Option Plans are these amended and restated 1997 Stock Options Plans and reserve an aggregate of 25,615,339 shares of common stock of the Company held by Endo Pharma LLC for issuance. Stock options granted under the Endo Pharma LLC 1997 Stock Option Plans expire on August 26, 2007. The effect of the recapitalization has been reflected in the accompanying financial statements. Upon exercise of these stock options, only currently outstanding shares of common stock of the Company held by Endo Pharma LLC will be issued. As a result, exercise of these stock options will not result in the issuance of additional shares of Company common stock and will not dilute the ownership of our other public stockholders.

The Class C stock options vest in four discrete tranches contingent upon (i) the common stock of the Company exceeding an average defined closing price threshold for ninety consecutive trading days, (ii) the closing price of the common stock of the Company on the last trading day of such ninety consecutive trading day period being greater than or equal to 85% of the defined closing price and (iii) the holder being a director, officer or employee of the Company or any of its subsidiaries on such date. The defined closing price thresholds are as follows:

Option Class	Common Stock Closing Price Threshold
C1A and C1B	$ 4.28
C2	$ 6.62
C3	$10.58
C4	$17.29

As these share price targets are achieved, resulting in the vesting of each tranche of options, the Company has recorded non-cash compensation charges related to the vesting of the applicable options. Under performance-based options, the measurement of expense is calculated and recorded as a non-cash charge at the time performance is achieved as the difference between the market price of the stock and the exercise price of the options. If these charges are recorded by the Company in connection with the above options, they will be significant. They will, however, not result in the issuance of additional shares of Company common stock.

During the year ended December 31, 2002, 6,924,363 Class C3 stock options vested upon achievement of the aforementioned conditions. Accordingly, we recorded a $34.7 million compensation charge related to the vesting of these performance-based stock options. The amount represents the estimated difference in the market price of the Company common stock on the date of vesting and the exercise price of the vested stock options.

During the year ended December 31, 2001, 4,594,535 Class C2 stock options vested upon achievement of the

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aforementioned conditions. We recorded a $37.3 million compensation charge related to the vesting of these performance-based stock options. The amount represents the estimated difference in the market price of the Company common stock on the date of vesting and the exercise price of the vested stock options.

During the year ended December 31, 2000, 5,880,713 Class C1A and C1B stock options vested upon achievement of the aforementioned conditions. We recorded a $15.3 million compensation charge related to the vesting of these performance-based stock options. The amount represents the estimated difference in the market price of the Company common stock on the date of vesting and the exercise price of the vested stock options.

The remaining unvested class of performance-based stock options (Class C4) under the Endo Pharma LLC 1997 Stock Option Plans and the Endo Pharma LLC 2000 Supplemental Executive and Employee Stock Option Plans (see below) will vest upon (i) the common stock of the Company exceeding an average closing price threshold of $17.29 for ninety consecutive trading days, (ii) the closing price of our common stock on the last trading day of such ninety consecutive trading day period being greater than or equal to $14.70 and (iii) the holder being a director, officer or employee of the Company or any of our subsidiaries on such date. The vesting of these approximately 5.0 million outstanding Class C4 stock options will result in an additional compensation charge, which would be approximately $75 million if the market price of our common stock on the date the vesting occurs is $17.29. Accordingly, if this vesting occurs, this charge will be substantial. As stated above, these options are exercisable solely into shares of Company common stock that are held by Endo Pharma LLC. As a result, the exercise of these options will not result in the issuance of additional shares of Company common stock and will not dilute the ownership of our other public stockholders.

The Class C1A, C1B, C2, C3 and C4 stock options are generally exercisable, if vested, upon the earlier of (i) the occurrence of a sale, disposition or transfer of Company common stock, after which neither Kelso & Company nor Endo Pharma LLC any longer own any shares of Company common stock or (ii) January 1, 2006.

In addition, Endo Pharma LLC, and not us, will receive the exercise price payable in connection with these stock options. Finally, the shares of common stock that individuals receive upon exercise of stock options pursuant to the Endo Pharma LLC 1997 Stock Option Plans are currently subject to significant restrictions that are set forth in stockholders agreements.

Endo Pharma LLC 2000 Supplemental Executive and Employee Stock Option Plans

In connection with the Algos merger and our related recapitalization on July 17, 2000, the Endo Pharma LLC 2000 Supplemental Employee Stock Option Plan and the Endo Pharma LLC 2000 Supplemental Executive Stock Option Plan (collectively, the Endo Pharma LLC 2000 Supplemental Stock Option Plans and, together with the Endo Pharma LLC 1997 Stock Option Plans, the Endo Pharma LLC Stock Option Plans) were established. The Endo Pharma LLC 2000 Supplemental Stock Option Plans reserve an aggregate of 10.7 million shares of our common stock that is held by Endo Pharma LLC for issuance. The Endo Pharma LLC 2000 Supplemental Stock Option Plans were not effective until January 1, 2003. The Endo Pharma LLC 2000 Supplemental Stock Option Plans became effective on January 1, 2003, resulting in the issuance of approximately 10.7 million stock options to certain employees and members of management. Because approximately 9.2 million of these stock options were immediately vested upon their issuance, we recorded a non-cash compensation charge of approximately $48.5 million in the first quarter of 2003 representing the difference between the market price of the common stock of $7.70 and the weighted average exercise price of these stock options of $2.42. Upon exercise of these options, no additional shares of Company common stock will be issued, however, because these stock options are exercisable only into shares of Company common stock that are held by Endo Pharma LLC. Accordingly, these stock options will not dilute the ownership of our other public stockholders. In addition, Endo Pharma LLC, and not us, will receive the exercise price payable in connection with these stock options. Further, the shares of common stock that individuals receive upon exercise of stock options granted pursuant to the Endo Pharma LLC 2000 Supplemental Stock Option Plans are currently subject to significant restrictions that are set forth in stockholders agreements.

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Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan

All the stock options we have granted pursuant to the Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan have exercise prices equal to the market price of our common stock on the date granted and, under generally accepted accounting principles, a measurement date occurs on the date of each grant. Consequently, we do not expect to incur a charge upon the vesting or exercise of those options.

Stock-Based Compensation

We have adopted the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, while following Accounting Pronouncements Bulletin (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for all of our stock option plans. Under APB No. 25, no compensation expense is recognized when the exercise price of stock options equals at least the market price of the underlying stock at the date of grant or when a measurement date has not yet been reached. Accordingly, with respect to the stock options granted under the Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan and with respect to the Class C4 stock options granted under the Endo Pharma LLC Stock Option Plans, no compensation expense has been recognized. If we were to have adopted the accounting provisions of SFAS No. 123, we would have been required to record compensation expense based on the fair value of all of these stock options on the date of their respective grants.

Pro-forma information regarding net income is required to be presented as if we had accounted for our stock options under the provisions of SFAS No. 123. The following assumptions were used for such estimates: no dividend yield; expected volatility of 65% in 2003 and 2002; risk-free interest rate of 4.0% for 2003 and 2002; and a weighted average expected life of the stock options of 5 years. Had the accounting provisions of SFAS No. 123 been adopted, net income would have been as follows (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net income	$ 45,168	$ 22,001	$ 61,527	$ 27,377
APB 25 Compensation Expense			48,514	
Tax effect of APB 25 compensation expense			(18,564)	
SFAS 123 compensation expense	(197)	(63)	(65,350)	(407)
Tax effect of SFAS 123 compensation expense	75	23	25,006	153
Net income pro forma	$ 45,046	$ 21,961	$ 51,133	$ 27,123
Basic earnings per share as reported	$ .34	$ .22	$ .49	$ .27
Basic earnings per share pro forma	$ .34	$ .22	$ .41	$ .27
Diluted earnings per share as reported	$ .34	$ .22	$ .46	$ .27
Diluted earnings per share pro forma	$ .34	$ .21	$ .39	$ .27
Weighted average shares outstanding				
Basic	131,734	102,064	125,014	102,064
Diluted	132,667	102,271	132,419	102,276

5. WARRANTS

Class A Transferable Warrants and Class B Non-Transferable Warrants

Prior to March 31, 2003, our Class A Transferable Warrants and Class B Non-Transferable Warrants were exercisable at an exercise price of $.01 per share into a specified number of shares of Company common stock depending on the timing of the FDA s approval of MorphiDex® for one or more pain indications.

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Because MorphiDex® was not approved prior to March 31, 2003, the Class A Transferable Warrants and Class B Non-Transferable Warrants expired on such date and have no economic value. Accordingly, the Company de-listed the Class A Transferable Warrants (Nasdaq: ENDPW) upon their expiration.

On December 5, 2001, we commenced a tender offer to purchase up to 13.5 million of our outstanding Class A Transferable Warrants and any and all of our outstanding Class B Non-Transferable Warrants. This tender offer expired at midnight on January 25, 2002. We accepted an aggregate of 8.6 million Class A Transferable Warrants and Class B Non-Transferable Warrants for payment at a purchase price of $0.75 per warrant. We used cash on hand to finance the purchase of the tendered warrants. Following the purchase by us, there were outstanding 9.2 million of these warrants.

Pre-Merger Endo Warrants

The holders of Company common stock prior to the Algos merger received warrants (known as the Pre-Merger Endo Warrants), which were exercisable at an exercise price of $.01 per share into a specified number of shares of Company common stock if the FDA did not approve MorphiDex® for any pain indication prior to December 31, 2002. As of December 31, 2002, there were outstanding 71.3 million of these warrants. As the FDA did not approve MorphiDex® before December 31, 2002, these warrants then became exercisable. Each of these outstanding 71.3 million warrants were exercisable into 0.416667 shares of Company common stock. These warrants were exercisable at an exercise price of $0.01 per share into a maximum of 29.7 million shares of Company common stock. As of July 8, 2003, all of the 71.3 million warrants had been exercised into 29,687,602 shares of Company common stock.

6. RELATED PARTY TRANSACTIONS

On July 14, 2000, Endo Pharma LLC was formed in connection with the Algos merger to ensure that the stock options granted pursuant to the Endo Pharma LLC Stock Option Plans diluted only the Endo common stock held by persons and entities that held such shares prior to our merger with Algos. Upon the exercise of these stock options, only currently outstanding shares of our common stock held by Endo Pharma LLC will be delivered. Because Endo Pharma LLC, and not us, will provide the shares upon the exercise of these options, we have entered into a tax sharing agreement with Endo Pharma LLC under which we will be required to pay to Endo Pharma LLC upon the occurrence of a liquidity event, as described further below, the amount of the tax benefits usable by us as a result of the exercise of these stock options into shares of our common stock held by Endo Pharma LLC. As of June 30, 2003, approximately 1.6 million of these stock options had been exercised by former employees into shares of our common stock held by Endo Pharma LLC. Upon exercise of any of these Endo Pharma LLC stock options, we generally will be permitted to deduct as a compensation charge, for federal income tax purposes, an amount equal to the difference between the market price of our common stock and the exercise price paid upon exercise of these options (as of June 30, 2003, approximately $13 million), which is estimated to result in a tax benefit amount of approximately $5 million. Under the tax sharing agreement, we are required to pay this $5 million to Endo Pharma LLC upon the occurrence of a liquidity event, as described further below, to the extent that a compensation charge deduction is usable to reduce our taxes and based upon the assumption that all other deductions of Endo are used prior thereto.

Using a weighted average exercise price of $2.61 per share and an assumed effective tax rate of 38.3%, if all 36.3 million stock options under the Endo Pharma LLC Stock Option Plans were vested and exercised (including the 1.6 million stock options already exercised as discussed above):

upon exercise, assuming the market price of our common stock is then $10.00 per share, we generally would be able to deduct, for federal income tax purposes, compensation of approximately $268 million, which could result in a tax benefit amount of approximately $103 million payable to Endo Pharma LLC.

upon exercise, assuming the market price of our common stock is then $15.00 per share, we generally would be able to deduct, for federal income tax purposes, compensation of approximately $450 million, which could result in a tax benefit amount of approximately $172 million payable to Endo Pharma LLC.

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upon exercise, assuming the market price of our common stock is then $20.00 per share, we generally would be able to deduct, for federal income tax purposes, compensation of approximately $631 million, which could result in a tax benefit amount of approximately $242 million payable to Endo Pharma LLC.

Under the terms of the tax sharing agreement, we must pay all such tax benefit amounts to Endo Pharma LLC to the extent these tax benefits are usable by us, as described above. However, these payments need only be made to Endo Pharma LLC upon the occurrence of a liquidity event, which is generally defined as a transaction or series of transactions resulting in (a) a sale of greater than 20% on a fully diluted basis of our common equity (either through (i) a primary offering by us, (ii) a secondary sale by Endo Pharma LLC or other holders of common stock pursuant to a registration rights agreement or (iii) a combination of both such primary and secondary offerings), (b) a change in control of Endo or (c) a sale of all or substantially all of our assets. In accordance with the tax sharing agreement, no payments have been made or accrued to date. On July 8, 2003, a secondary sale by Endo Pharma LLC was closed which represented a sale of, on a fully diluted basis, approximately 12% of our common equity which did not, by itself, trigger a payment under the tax sharing agreement, and was not a liquidity event. This recent offering may, however, be combined with future offerings to result in a series of transactions that will trigger a payment obligation pursuant to the tax sharing agreement. Endo Pharma LLC has informed us that, subject to a variety of factors, including market conditions and stock price levels, it may initiate additional secondary offerings of our common stock in the future.

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7. COMMITMENTS AND CONTINGENCIES

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

We have entered into certain collaboration agreements with third parties for the development of pharmaceutical products. These agreements may require us to share in the development costs of such products, make payments to these third parties upon the achievement of certain defined milestones, make payments to such third parties based on a percentage of the net sales of such products and generally grant marketing rights to us for such products. If any of our third party partners are unable or unwilling to fund their portion of the particular collaboration project with us, this may adversely affect our results of operations and cash flows in the foreseeable future. On March 18, 2003, we received notice from Penwest Pharmaceuticals Co. (a collaboration partner of Endo with which Endo has an alliance agreement and with which Endo is developing its pipeline project, oxymorphone ER) that it was exercising its right under the agreement to cease funding its share of the development and pre-launch marketing costs of oxymorphone ER on account of their concern about their ability to access external capital funding opportunities in the future. Accordingly, we are now responsible for funding 100% of these remaining costs until such time as the FDA approves oxymorphone ER, at which time we will recoup from the royalties due to Penwest the full amount of what Penwest should have contributed had it not exercised such right. We believe that our cash and cash equivalents and cash flow from operating activities will be more than sufficient to meet our normal operating, investing and financing activities in the foreseeable future, including the funding of 100% of the costs to bring our pipeline products, including oxymorphone ER, to market.

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

Except for the historical information contained in this Report, this Report, including the following discussion, contains forward-looking statements that involve risks and uncertainties.

Overview

We, through our wholly owned subsidiary, Endo Pharmaceuticals Inc., are engaged in the research, development, sales and marketing of branded and generic prescription pharmaceuticals used primarily for the treatment and management of pain. Branded products comprised approximately 67%, 63% and 71% of net sales for the years ended December 31, 2001, 2002 and the six months ended June 30, 2003, respectively.

On August 26, 1997, certain members of the management of the then DuPont Merck Pharmaceutical Company and an affiliate of Kelso & Company entered into an asset purchase agreement with DuPont Merck to acquire certain branded and generic pharmaceutical products and exclusive worldwide rights to a number of new chemical entities in the DuPont research and development pipeline from DuPont Merck through the newly-formed Endo Pharmaceuticals Inc. On November 19, 1999, we formed Endo Inc. as a wholly owned subsidiary to effect the acquisition of Algos Pharmaceutical Corporation. On December 31, 2001, Endo Inc. was merged with and into Endo Pharmaceuticals Inc. The stock of Endo Pharmaceuticals Inc. is our only asset and we have no other operations or business.

In May 2001, we entered into a long-term manufacturing and development agreement with Novartis Consumer Health, Inc., whereby Novartis has agreed to manufacture certain of our commercial products and products in development. We have incurred and expect to continue to incur significant costs associated with the preparation of Novartis manufacturing operations under this agreement. These costs primarily relate to the preparation of test batches of drug product for FDA approval and our own quality assessment and administrative costs relating to the shifting of existing production to Novartis. During the six months ending June 30, 2003 and 2002, we incurred approximately $3.1 million and $1.3 million of these costs, respectively, which are reflected in research and development expense.

Our quarterly results have fluctuated in the past, and may continue to fluctuate. These fluctuations are primarily due to the timing of new product launches, purchasing patterns of our customers, market acceptance of our products and the impact of competitive products and pricing.

Critical Accounting Policies

To understand our financial statements, it is important to understand our accounting policies. The preparation of our financial statements in conformity with accounting principles generally accepted in the United States (generally accepted accounting principles) requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are required in the determination of sales deductions for estimated chargebacks, rebates, sales incentives and allowances, royalties and returns and losses. Significant estimates and assumptions are also required in the appropriateness of amortization periods for identifiable intangible assets and the potential impairment of goodwill and other intangible assets. Some of these judgments can be subjective and complex, and, consequently, actual results may differ from these estimates. For any given individual estimate or assumption made by us, there may also be other estimates or assumptions that are reasonable. We believe, however, that given current facts and circumstances, it is unlikely that applying any such other reasonable judgment would cause a material adverse effect on our consolidated results of operations, financial position or cash flows for the periods represented in this section. Our most critical accounting policies are described below:

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Sales Deductions

When we recognize revenue from the sale of our products, we simultaneously record an adjustment to revenue for estimated chargebacks, rebates, sales incentives and allowances, royalties and returns and losses. These provisions are estimated based on historical experience, estimated future trends, estimated customer inventory levels, current contract sales terms with our wholesale and indirect customers and other competitive factors. If the assumptions we used to calculate these adjustments do not appropriately reflect future activity, our financial position, results of operations and cash flows could be impacted. The provision for chargebacks is the most significant and complex estimate used in the recognition of our revenue. We establish contract prices for indirect customers who are supplied by our wholesale customers. A chargeback represents the difference between our invoice price to the wholesaler and the indirect customer s contract price. Provisions for estimating chargebacks are calculated primarily using historical chargeback experience, estimated wholesaler inventory levels and estimated future trends. We establish contracts with wholesalers, chain stores and indirect customers that provide for rebates, sales incentives and other allowances. Some customers receive rebates upon attaining established sales volumes. We estimate rebates, sales incentives and other allowances based upon the terms of the contracts with our customers, historical experience, estimated inventory levels of our customers and estimated future trends. We estimate an accrual for Medicaid rebates as a reduction of revenue at the time product sales are recorded. The Medicaid rebate reserve is estimated based upon the historical payment experience, historical relationship to revenues and estimated future trends. Royalties represent amounts accrued pursuant to the license agreement with Hind Healthcare Inc. (Hind). Royalties are recorded as a reduction to net sales due to the nature of the license agreement and the characteristics of the license involvement by Hind in Lidoderm®. Royalties are paid to Hind at a rate of 10% of net sales of Lidoderm®. Our return policy allows customers to receive credit for expired products within three months prior to expiration and within one year after expiration. We estimate the provision for product returns based upon the historical experience of returns for each product, historical relationship to revenues, estimated future trends, estimated customer inventory levels and other competitive factors. We continually monitor the factors that influence each type of sales deduction and make adjustments as necessary.

Amortizable Intangibles: Licenses

Licenses are stated at cost, less accumulated amortization, and are amortized using the straight-line method over their estimated useful lives ranging from seventeen to twenty years. We determine amortization periods for licenses based on our assessment of various factors impacting estimated useful lives and cash flows of the acquired rights. Such factors include the expected launch date of the product, the strength of the intellectual property protection of the product and various other competitive, developmental and regulatory issues, and contractual terms. Significant changes to any of these factors may result in a reduction in the useful life of the license and an acceleration of related amortization expense, which could cause our operating income, net income and earnings per share to decrease. Licenses are assessed periodically for impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of* (SFAS No. 144). The impairment testing involves comparing the carrying amount of the asset to the forecasted undiscounted future cash flows of the product. In the event the carrying value of the asset exceeds the undiscounted future cash flows of the product and the carrying value is not considered recoverable, an impairment exists. An impairment loss is measured as the excess of the asset s carrying value over its fair value, calculated using a discounted future cash flow method. An impairment loss would be recognized in net income in the period that the impairment occurs.

Goodwill and Other Intangibles

Effective January 1, 2002, we adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets,* and will no longer amortize goodwill and workforce in place. Goodwill and other intangibles represents a significant portion of our assets and stockholders equity. As of June 30, 2003, goodwill and other intangibles comprised approximately 33% of our total assets and 47% of our stockholders equity. We assess the potential impairment of goodwill by comparing the fair value of goodwill to its carrying value for our one reporting unit. An impairment loss would be recognized when the estimated fair value is less than its carrying amount. As a result of the significance of

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goodwill, our results of operations and financial position in a future period could be negatively impacted should an impairment of goodwill occur.

We have one reportable segment, pharmaceutical products. Goodwill arose as a result of the August 26, 1997 acquisition of certain branded and generic pharmaceutical products, related rights and certain assets of the then DuPont Merck Pharmaceutical Company (n/k/a Bristol-Myers Squibb Pharma Company) and the July 17, 2000 acquisition of Algos. Although goodwill arose in two separate transactions, the components of our operating segment have been integrated and are managed as one reporting unit. Our components extensively share assets and other resources with the other components of our business and have similar economic characteristics. In addition, our components do not maintain discrete financial information. Accordingly, the components of our business have been aggregated into one reporting unit and are evaluated as such for goodwill impairment. Goodwill is evaluated for impairment on an annual basis on January 1st of each year unless events or circumstances indicate that an impairment may have occurred between annual dates. Goodwill has been evaluated for impairment upon the adoption of SFAS No. 142 on January 1, 2002 and, based on the fair value of our reporting unit, no impairment has been identified. On January 1, 2003, our goodwill was evaluated for impairment and, based on the fair value of our reporting unit, no impairment was identified.

Our goodwill and other intangible assets consist of the following (in thousands):

	June 30, 2003	December 31, 2002
Goodwill	$181,079	$181,079
Amortizable Intangibles:		
Licenses	$ 36,000	$ 36,000
Patents	3,200	3,200
	39,200	39,200
Less accumulated amortization	(3,551)	(2,445)
Other Intangibles, net	$ 35,649	$ 36,755

Effective January 1, 2002, we reclassified the carrying amount of workforce-in-place as goodwill. The cost of license fees is capitalized and is being amortized using the straight-line method over the licenses estimated useful lives of seventeen to twenty years. The cost of acquired patents is capitalized and is being amortized using the

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straight-line method over their estimated useful lives of seventeen years.

Estimated amortization of intangibles for the five fiscal years subsequent to December 31, 2002 is as follows (in thousands):

2003	$2,212
2004	2,212
2005	2,212
2006	2,212
2007	2,212

Compensation Related to Stock Options Endo Pharma LLC Stock Option Plans

In our 2000 fiscal year we incurred a non-cash charge of $15.3 million, in our 2001 fiscal year we recorded a non-cash charge of $37.3 million and in our 2002 fiscal year we recorded a non-cash charge of $34.7 million, in each case for stock-based compensation relating to the vesting of options that were issued under the Endo Pharma LLC 1997 Amended and Restated Executive Stock Option Plan and the Endo Pharma LLC 1997 Amended and Restated Employee Stock Option Plan (together, the Endo Pharma LLC 1997 Stock Option Plans). Under the Endo Pharma LLC 1997 Stock Option Plans, tranches of options vest when we attain certain stock price targets. As each tranche vests, we incur a non-cash charge representing the difference between the market price of the shares underlying the options and the exercise price of such options.

In connection with the Algos merger and our related recapitalization on July 17, 2000, the Endo Pharma LLC 2000 Supplemental Employee Stock Option Plan and the Endo Pharma LLC 2000 Supplemental Executive Stock Option Plan (collectively, the Endo Pharma LLC 2000 Supplemental Stock Option Plans and, together with the Endo Pharma LLC 1997 Stock Option Plans, the Endo Pharma LLC Stock Option Plans) were established. The Endo Pharma LLC 2000 Supplemental Stock Option Plans reserve an aggregate of 10.7 million shares of our common stock that is held by Endo Pharma LLC for issuance. The Endo Pharma LLC 2000 Supplemental Stock Option Plans were not effective until January 1, 2003. The Endo Pharma LLC 2000 Supplemental Stock Option Plans became effective on January 1, 2003, resulting in the issuance of approximately 10.7 million stock options to certain employees and members of management. Because approximately 9.2 million of these stock options were immediately vested upon their issuance, we recorded a non-cash compensation charge of approximately $48.5 million in the first quarter of 2003 representing the difference between the market price of the common stock of $7.70 and the weighted average exercise price of these stock options of $2.42. Upon exercise, no additional shares of our common stock will be issued, however, because these stock options are exercisable only into shares of our common stock that are held by Endo Pharma LLC. Accordingly, these stock options do not dilute the public shareholders. In addition, Endo Pharma LLC, and not us, will receive the exercise price payable in connection with these options. Further, the shares of common stock that individuals receive upon exercise of stock options granted pursuant to the Endo Pharma LLC 2000 Supplemental Stock Option Plans are currently subject to significant restrictions that are set forth in stockholders agreements.

The remaining unvested class of performance-based stock options (Class C4) under the Endo Pharma LLC Stock Option Plans will vest upon (i) our common stock exceeding an average closing price threshold of $17.29 for ninety consecutive trading days, (ii) the closing price of our common stock on the last trading day of such ninety consecutive trading day period being greater than or equal to $14.70 and (iii) the holder being a director, officer or employee of the Company or any of our subsidiaries on such date. If this vesting occurs, this charge will be substantial. For example, the vesting of the approximately 5.0 million outstanding Class C4 stock options will result in an additional compensation charge to us, which would be approximately $75 million if the market price of our stock is $17.29 on the date the vesting occurs. As stated above, these options are exercisable solely into shares of our common stock that are presently held by Endo Pharma LLC. As a result, the exercise of these options will not result in the issuance of additional shares of common stock and will not dilute the ownership of our other public stockholders. Further, the shares of common stock that individuals receive upon exercise of stock options granted

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pursuant to the Endo Pharma LLC Stock Option Plans are currently subject to significant restrictions that are set forth in stockholders agreements.

Compensation Related to Stock Options Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan

All the stock options we have granted pursuant to the Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan have exercise prices equal to the market price of our stock on the date granted and, under generally accepted accounting principles, a measurement date occurs on the date of each grant. Consequently, we do not expect to incur a charge upon the vesting or exercise of those options.

Results of Operations

Net Sales

Our net sales consist of revenues from sales of our pharmaceutical products, less estimates for certain chargebacks, sales allowances, the cost of returns and losses. We recognize revenue when products are shipped and title and risk of loss has passed to the customer, which is typically upon delivery to the customer. Our shipping terms are free on board customer s destination.

The following table presents our unaudited net sales by product category for the three months and six months ended June 30, 2003 and 2002.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(in thousands, unaudited)			
Percocet®	$ 52,434	$ 40,610	$107,893	$ 64,078
Lidoderm®	50,617	25,834	92,107	35,836
Other brands	8,098	4,295	15,477	9,621
Total brands	$111,149	$ 70,739	$215,477	$109,535
Total generics	$ 40,878	$ 37,163	$ 88,824	$ 65,393
Total net sales	$152,027	$107,902	$304,301	$174,928

The following table presents our unaudited net sales of select products as a percentage of total net sales for the three months and six months ended June 30, 2003 and 2002.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(unaudited)			
Percocet®	35%	38%	36%	37%
Lidoderm®	33	24	30	20
Other brands	5	4	5	6
Total brands	73	66	71	63
Total generics	27	34	29	37
Total net sales	100%	100%	100%	100%

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Three Months Ended June 30, 2003 Compared to the Three Months Ended June 30, 2002

Net Sales. Net sales for the three months ended June 30, 2003 increased by 41% to $152.0 million from $107.9 million in the comparable 2002 period. This increase in net sales was primarily due to the increase in the net sales of Lidoderm®, the first FDA-approved product for the treatment of the pain of post-herpetic neuralgia, the new strengths of Percocet®, and certain generic products. Net sales of Lidoderm® increased to $50.6 million from $25.8 million in the comparable 2002 period. In September 1999, we launched Lidoderm®, which continues to gain market share due to our ongoing promotional and educational efforts. Percocet® net sales increased to $52.4 million from $40.6 million in the comparable 2002 period due to the new strengths of Percocet® launched in November 2001. In April 2001, generic equivalents of Percocet® 7.5/500 and Percocet® 10.0/650 were introduced. In November 2001, we launched Percocet® 7.5/325 and Percocet® 10.0/325 which do not currently have generic equivalents. Net sales of our generic products increased 10% to $40.9 million from $37.2 million in the comparable 2002 period primarily due to the growth of our generic morphine sulfate extended-release tablets. In November 1998, we launched the 15mg, 30mg and 60mg strengths, in May 2001, we launched the 100mg strength and in September 2001, we launched the 200mg strength of our generic morphine sulfate extended-release tablets. These products continue to gain market share. On July 3, 2003, the FDA approved two strengths of another company s version of generic extended-release morphine sulfate (100 mg and 200 mg), and on July 31, 2003, the FDA approved this company s remaining three strengths (15 mg, 30 mg and 60 mg). Generic competition with our products may have a material impact on our results of operations and cash flows in the future.

Gross Profit. Gross profit for the three months ended June 30, 2003 increased by 57% to $125.8 million from $80.1 million in the comparable 2002 period. Gross profit margins increased to 83% from 74% due to a more favorable mix of higher margin brand and generic products resulting from the products discussed above. In addition, the increase in gross profit margins was also due to the existing fixed cost nature of our manufacturing relationship with Bristol-Myers Squibb Pharma Company (f/k/a The DuPont Merck Pharmaceutical Company), currently one of our most significant contract manufacturing relationships.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended June 30, 2003 increased by 51% to $41.8 million from $27.6 million in the comparable 2002 period. This increase was due to a $7.0 million increase in sales and promotional efforts in 2003 over the comparable 2002 period to support Lidoderm® and Percocet® and in preparation of new product launches. In addition, we experienced an increase in costs in the general and administrative functions in order to support our new product marketing and new product development.

Research and Development Expenses. Research and development expenses for the three months ended June 30, 2003 decreased by 38% to $9.4 million from $15.1 million in the comparable 2002 period. This decrease reflects the overall stage of development of our development portfolio. During 2002, we were performing clinical trials on our extended-release and immediate-release oxymorphone products and MorphiDex®. During 2003, our development efforts are focused on our oral mucositis product which is currently in Phase III clinical trials as well as other earlier stage projects focused in the area of pain management and other complementary therapeutic areas.

Depreciation and Amortization. Depreciation and amortization for the three months ended June 30, 2003 increased to $1.4 million from $0.7 million in the comparable 2002 period primarily due to an increase in amortization of license fees arising from the SkyePharma license entered into on December 31, 2002.

Interest Expense, Net. Interest expense, net for the three months ended June 30, 2003 decreased to twenty-two thousand dollars from $1.6 million in the comparable 2002 period. This decrease is substantially due to the repayment on August 26, 2002 of the promissory notes issued to Bristol-Myers Squibb in connection with our 1997 acquisition from Bristol-Myers Squibb Pharma Company (f/k/a The Dupont Merck Pharmaceutical Company).

Income Tax. Income tax for the three months ended June 30, 2003 increased to $28.0 million from $13.1 million in the comparable 2002 period. This increase is due to the increase in income before income tax for the three months ended June 30, 2003.

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Six Months Ended June 30, 2003 Compared to the Six Months Ended June 30, 2002

Net Sales. Net sales for the six months ended June 30, 2003 increased by 74% to $304.3 million from $174.9 million in the comparable 2002 period. This increase in net sales was primarily due to the increase in the net sales of Lidoderm®, the first FDA-approved product for the treatment of the pain of post-herpetic neuralgia, the new strengths of Percocet®, and certain generic products. Net sales of Lidoderm® increased to $92.1 million from $35.8 million in the comparable 2002 period. In September 1999, we launched Lidoderm®, which continues to gain market share due to our ongoing promotional and educational efforts. Percocet® net sales increased to $107.9 million from $64.1 million in the comparable 2002 period due to the new strengths of Percocet® launched in November 2001. In April 2001, generic equivalents of Percocet® 7.5/500 and Percocet® 10.0/650 were introduced. In November 2001, we launched Percocet® 7.5/325 and Percocet® 10.0/325 which do not currently have generic equivalents. In addition for the six months ended June 30, 2003, each of Percocet® and Lidoderm® were favorably impacted from our customers increasing their inventories back to normalized levels from the relatively low levels that were maintained at the end of 2002. Net sales of our generic products increased 36% to $88.8 million from $65.4 million in the comparable 2002 period primarily due to the growth of our generic morphine sulfate extended-release tablets and Endocet®. In November 1998, we launched the 15mg, 30mg and 60mg strengths, in May 2001, we launched the 100mg strength and in September 2001, we launched the 200mg strength of our generic morphine sulfate extended-release tablets. These products continue to gain market share. On July 3, 2003, the FDA approved two strengths of another company s version of generic extended-release morphine sulfate (100 mg and 200 mg) , and on July 31, 2003, the FDA approved this company s remaining three strengths (15 mg, 30 mg and 60 mg). In April 2001, we launched two new strengths of our generic product Endocet®. Generic competition with our products may have a material impact on our results of operations and cash flows in the future.

Gross Profit. Gross profit for the six months ended June 30, 2003 increased by 95% to $250.5 million from $128.2 million in the comparable 2002 period. Gross profit margins increased to 82% from 73% due to a more favorable mix of higher margin brand and generic products resulting from the products discussed above. In addition, the increase in gross profit margins was also due to the existing fixed cost nature of our manufacturing relationship with Bristol-Myers Squibb Pharma Company (f/k/a The DuPont Merck Pharmaceutical Company), currently one of our most significant contract manufacturing relationships.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the six months ended June 30, 2003 increased by 52% to $77.9 million from $51.1 million in the comparable 2002 period. This increase was due to a $15.0 million increase in sales and promotional efforts in 2003 over the comparable 2002 period to support Lidoderm® and Percocet® and in preparation of new product launches. In addition, we experienced an increase in costs in the general and administrative functions in order to support our new product marketing and new product development.

Research and Development Expenses. Research and development expenses for the six months ended June 30, 2003 decreased by 25% to $21.5 million from $28.5 million in the comparable 2002 period. This decrease reflects the overall stage of development of our development portfolio. During 2002, we were performing clinical trials on our extended-release and immediate-release oxymorphone products and MorphiDex®. During 2003, our development efforts are focused on our oral mucositis product which is currently in Phase III clinical trials as well as other earlier stage projects focused in the area of pain management and other complementary therapeutic areas.

Depreciation and Amortization. Depreciation and amortization for the six months ended June 30, 2003 increased to $2.7 million from $1.5 million in the comparable 2002 period primarily due to an increase in amortization of license fees arising from the SkyePharma license entered into on December 31, 2002.

Compensation Related to Stock Options. Compensation related to stock options was $48.5 million during the six months ended June 30, 2003. Effective January 1, 2003, the Endo Pharma LLC 2000 Supplemental Stock Option Plans became effective resulting in the issuance of approximately 10.7 million stock options to certain employees and members of management. Because approximately 9.2 million of these stock options were immediately vested upon their issuance, we recorded a non-cash compensation charge of approximately $48.5 million in the first quarter of 2003 representing the difference between the market price of the common stock of $7.70 and the exercise price of

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these stock options of $2.42. No additional shares of our common stock will be issued, however, because these stock options are exercisable only into shares of our common stock that are held by Endo Pharma LLC. Accordingly, these stock options do not dilute the ownership of our other public stockholders.

Interest Expense, Net. Interest expense, net for the six months ended June 30, 2003 decreased to $.2 million from $3.3 million in the comparable 2002 period. This decrease is substantially due to the repayment on August 26, 2002 of the promissory notes issued to Bristol-Myers Squibb in connection with our 1997 acquisition from Bristol-Myers Squibb Pharma Company (f/k/a The Dupont Merck Pharmaceutical Company).

Income Tax. Income tax for the six months ended June 30, 2003 increased to $38.1 million from $16.4 million in the comparable 2002 period. This increase is due to the increase in income before income tax for the six months ended June 30, 2003.

Liquidity and Capital Resources

Our principal source of liquidity is cash generated from operations. Under our credit facility, we may borrow up to $75.0 million on a revolving basis for certain purposes as described below. Our principal liquidity requirements are for working capital for operations, acquisitions, licenses and capital expenditures.

Net Cash Provided by Operating Activities. Net cash provided by operating activities increased by $75.1 million to $139.1 million for the six months ended June 30, 2003 from $64.0 million for the six months ended June 30, 2002. This increase was due to the cash provided by the increase in net sales and gross profit for the six months ended June 30, 2003 compared to the six months ended June 30, 2002, offset by an increase in selling, general and administrative expenses for the six months ended June 30, 2003 as compared to the six months ended June 30, 2002.

Net Cash Used in Investing Activities. Net cash utilized in investing activities increased by $26.5 million to $27.3 million for the six months ended June 30, 2003. In January 2003, the Company paid a $25.0 million license fee to SkyePharma, Inc. for the marketing rights to DepoMorphine™ and Propofol IDD-D™. Capital expenditures increased in 2003 to $2.3 million from $.8 million. This increase in capital expenditures was due to the implementation of a sales automation system during 2003.

Net Cash Utilized in Financing Activities. Net cash utilized in financing activities decreased by $6.5 million to $.2 million for the six months ended June 30, 2003 from $6.7 million for the six months ended June 30, 2002. In January 2002, we utilized $6.7 million of cash, including fees, to repurchase 8.6 million of our Class A Transferable Warrants and Class B Non-Transferable Warrants.

Credit Facility. In December 2001, we amended and restated our senior secured credit facility with a number of lenders. This amended and restated credit facility provides us with a line of credit of $75.0 million. The line of credit matures on December 21, 2006. Any loans outstanding under the amended and restated credit facility are secured by a first priority security interest in substantially all of our assets. The credit facility contains representations and warranties, covenants, including a covenant requiring us to maintain minimum EBITDA of $50 million over the prior four-quarter period, events of default and other provisions customarily found in similar agreements. Our ability to borrow under the credit facility is dependent, among other things, on our compliance with those provisions. As of June 30, 2003, we have not borrowed any amounts under our credit facility.

Tax Sharing Agreement. On July 14, 2000, Endo Pharma LLC was formed in connection with the Algos merger to ensure that the stock options granted pursuant to the Endo Pharma LLC Stock Option Plans diluted only the Endo common stock held by persons and entities that held such shares prior to our merger with Algos. Upon the exercise of these stock options, only currently outstanding shares of our common stock held by Endo Pharma LLC will be delivered. Because Endo Pharma LLC, and not us, will provide the shares upon the exercise of these options, we have entered into a tax sharing agreement with Endo Pharma LLC under which we will be required to pay to Endo Pharma LLC upon the occurrence of a liquidity event, as described further below, the amount of the tax benefits usable by us as a result of the exercise of these stock options into shares of our common stock held by Endo Pharma LLC. As of June 30, 2003, approximately 1.6 million of these stock options had been exercised by former employees into shares of our common stock held by Endo Pharma LLC. Upon exercise of any of these Endo Pharma LLC stock

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options, we generally will be permitted to deduct as a compensation charge, for federal income tax purposes, an amount equal to the difference between the market price of our common stock and the exercise price paid upon exercise of these options (as of June 30, 2003, approximately $13 million), which is estimated to result in a tax benefit amount of approximately $5 million. Under the tax sharing agreement, we are required to pay this $5 million to Endo Pharma LLC upon the occurrence of a liquidity event, as described further below, to the extent that a compensation charge deduction is usable to reduce our taxes and based upon the assumption that all other deductions of Endo are used prior thereto.

Using a weighted average exercise price of $2.61 per share and an assumed effective tax rate of 38.3%, if all 36.3 million stock options under the Endo Pharma LLC Stock Option Plans were vested and exercised (including the 1.6 million stock options already exercised as discussed above):

- upon exercise, assuming the market price of our common stock is then $10.00 per share, we generally would be able to deduct, for federal income tax purposes, compensation of approximately $268 million, which could result in a tax benefit amount of approximately $103 million payable to Endo Pharma LLC.

- upon exercise, assuming the market price of our common stock is then $15.00 per share, we generally would be able to deduct, for federal income tax purposes, compensation of approximately $450 million, which could result in a tax benefit amount of approximately $172 million payable to Endo Pharma LLC.

- upon exercise, assuming the market price of our common stock is then $20.00 per share, we generally would be able to deduct, for federal income tax purposes, compensation of approximately $631 million, which could result in a tax benefit amount of approximately $242 million payable to Endo Pharma LLC.

Under the terms of the tax sharing agreement, we must pay all such tax benefit amounts to Endo Pharma LLC to the extent these tax benefits are usable by us, as described above. However, these payments need only be made to Endo Pharma LLC upon the occurrence of a liquidity event, which is generally defined as a transaction or series of transactions resulting in (a) a sale of greater than 20% on a fully diluted basis of our common equity (either through (i) a primary offering by us, (ii) a secondary sale by Endo Pharma LLC or other holders of common stock pursuant to a registration rights agreement or (iii) a combination of both such primary and secondary offerings), (b) a change in control of Endo or (c) a sale of all or substantially all of our assets. In accordance with the tax sharing agreement, no payments have been made or accrued to date. On July 8, 2003, a secondary sale by Endo Pharma LLC was closed which represented a sale of, on a fully diluted basis, approximately 12% of our common equity which did not, by itself, trigger a payment under the tax sharing agreement, and no liquidity event. This offering may, however, be combined with future offerings to result in a series of transactions that will trigger a payment obligation pursuant to the tax sharing agreement. Endo Pharma LLC has informed us that, subject to a variety of factors, including market conditions and stock price levels, it may initiate additional secondary offerings in the future

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

On December 21, 2001, we amended and restated our senior credit facility to provide for a line of credit of $75.0 million and a delayed draw term loan of $25.0 million. On August 27, 2002, the delayed draw term loan of $25.0 million expired unused. Borrowings under the $75.0 million line of credit are variable rate borrowings. There are no amounts outstanding under the line of credit. We do not utilize financial instruments for trading purposes and hold no derivative financial instruments that could expose us to significant market risk. We monitor interest rates and enter into interest rate agreements as considered appropriate.

Item 4. ***Controls and Procedures.***

Within 90 days prior to the filing of this Report, an evaluation was carried out by our Chief Executive Officer and Chief Financial Officer, with the assistance of other members of management, of the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 15d-14(c) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the date of such evaluation, the disclosure controls and procedures were effective in ensuring that all material information relating to

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the Company required to be included in the Company s reports filed or submitted under the Exchange Act was gathered, analyzed and reported or otherwise made known to them in a timely fashion. There have been no significant changes in our internal controls, or in other factors that could significantly affect these controls, subsequent to the date the evaluation was completed.

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PART II

OTHER INFORMATION

Item 1. ***Legal Proceedings.***

Purdue Pharma L.P., et al. v. Endo Pharmaceuticals Inc., et al., Index No. 00 Civ. 8029 (SHS) (S.D.N.Y.); Purdue Pharma L.P., et al. v. Endo Pharmaceuticals Inc., et al., Index No. 01 Civ. 2109 (SHS) (S.D.N.Y.); Purdue Pharma L.P., et al. v. Endo Pharmaceuticals Inc., et al., Index No. 01 Civ. 8177 (SHS) (S.D.N.Y.)

On October 20, 2000, The Purdue Frederick Company and related companies (Purdue Frederick) filed suit against us and our subsidiary, Endo Pharmaceuticals Inc. (EPI), in the U.S. District Court for the Southern District of New York alleging that EPI s bioequivalent version of Purdue Frederick s OxyContin (oxycodone hydrochloride extended-release tablets), 40mg strength, infringes three of its patents. This suit arose after EPI provided the plaintiffs with notice that its ANDA submission for a bioequivalent version of Purdue Frederick s OxyContin, 40mg strength, challenged the listed patents for OxyContin 40mg tablets. On March 13, 2001, Purdue Frederick filed a second suit against us and EPI in the U.S. District Court for the Southern District of New York alleging that EPI s bioequivalent versions of Purdue Frederick s OxyContin, 10mg and 20mg strengths, infringe the same three patents. This suit arose from EPI having amended its earlier ANDA on February 9, 2001 to add bioequivalent versions of the 10mg and 20mg strengths of OxyContin. On August 30, 2001, Purdue Frederick filed a third suit against us and EPI in the U.S. District Court for the Southern District of New York alleging that EPI s bioequivalent version of Purdue Frederick s OxyContin, 80mg strength, infringes the same three patents. This suit arose from EPI having amended its earlier ANDA on July 30, 2001 to add the bioequivalent version of the 80mg strength of OxyContin.

For each of the 10mg, 20mg, 40mg and 80mg strengths of this product, EPI made the required Paragraph IV certification against the patents listed in the FDA s Orange Book as covering these strengths of OxyContin. EPI has pleaded counterclaims that the patents asserted by Purdue Frederick are invalid, unenforceable and/or not infringed by EPI s formulation of oxycodone hydrochloride extended-release tablets, 10mg, 20mg, 40mg and 80mg strengths. EPI has also counterclaimed for antitrust damages based on allegations that Purdue Frederick obtained the patents through fraud on the United States Patent and Trademark Office and is asserting them while aware of their invalidity and unenforceability. However, we cannot make any assurances as to the outcome of this patent challenge. Purdue Frederick was granted a preliminary injunction (*Purdue Pharma L.P. v. Boehringer Ingelheim GmbH,* 98 F. Supp. 2d 362 (SDNY 2000)), which decision was affirmed on appeal (*Purdue Pharma L.P. v. Boehringer Ingelheim GmbH,* 237 F.3d 1359 (Fed. Cir. 2001)), against a different manufacturer based on the same patents that are being asserted against us and EPI, and in the same court in which Purdue Frederick sued. We believe the defenses rejected in the preliminary injunction decision and in the appellate decision do not substantially impact the principal defenses raised by us and EPI.

The district court began the trial of the patent claims in all three of the suits against EPI on June 2, 2003. Post-trial briefing was completed on August 8, 2003, and a decision on the patent claims is expected in due course. By an earlier order, the judge bifurcated the antitrust counterclaims for a separate and subsequent trial.

Litigation similar to that described above may also result from products we currently have in development, as well as those that we may develop in the future. We, however, cannot predict the timing or outcome of any such litigation, or whether any such litigation will be brought against us.

Rowe, et al. v. Bayer Corp., et al., No. 02-1833 (E.D. La.); In Re: PPA Products Liability Litigation, MDL No. 1407 (W.D. Wash.); Landry, et al. v. Bayer Corp., et al., No. 02-1835, (E.D. La.); In Re: PPA Products Liability Litigation, MDL No. 1407 (W.D. Wash.); Everidge, et al. v. Bayer Corp., et al., No. 02-1834 (E.D. La.); In Re: PPA Products Liability Litigation, MDL No. 1407 (W.D. Wash.); Ackel, et al. v. Bayer Corp., et al., No. 02-1831 (E.D. La.); In Re: PPA Products Liability Litigation, MDL No. 1407 (W.D. Wash.); Ashton, et al. v. Bayer Corp., et al., No. 02-598 (M.D. La.); In Re: PPA Products Liability Litigation, MDL No. 1407 (W.D. Wash.); McCullough, et al. v. American Home Products Corp., et al., No. CV02-1295-S (W.D. La.); In Re: PPA Products Liability Litigation, MDL No. 1407 (W.D. Wash.)

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On June 17, 2002, EPI was named, along with ten other pharmaceutical companies, as a defendant in four lawsuits filed by groups of 28, 34, 37, and 43 individual plaintiffs, respectively, in the United States District Court for the Eastern District of Louisiana. On June 18, 2002, EPI was named, along with ten other pharmaceutical companies, as a defendant in a lawsuit filed by Ellen McCullough and Brenda Businelle in the United States District Court for the Western District of Louisiana. On June 21, 2002, EPI was named, along with ten other pharmaceutical companies, as a defendant in a lawsuit filed by Joyce Ashton and Bernadine Johnson in the United States District Court for the Middle District of Louisiana. According to each of these six complaints, each of the defendant pharmaceutical companies allegedly manufactured and sold products containing phenylpropanolamine (PPA). Each complaint alleges that the defendants failed to adequately warn plaintiff of the hazards of the use of the subject products containing PPA and that as a result of this failure to warn, plaintiffs suffered injury. Each of these six cases has been transferred to the United States District Court for the Western District of Washington by order of the United States Judicial Panel on Multidistrict Litigation, where fact and expert discovery is underway. EPI intends to defend itself vigorously in each of these cases.

John Fontenot et al. v. Able Laboratories, Inc. et al., No. 98-845 (34th Judicial District Court for the Parish of St. Bernard, State of Louisiana)

On May 7, 2003, EPI was named, along with thirteen other pharmaceutical companies and four pharmacies, as a defendant in a lawsuit filed by John Fontenot, Helen Fontenot Serpas and Andre Paul Fontenot in the 34th Judicial District Court for the Parish of St. Bernard, State of Louisiana. Defendants removed the matter to the U.S. District Court, Eastern District of Louisiana, and a motion to remand, filed by plaintiffs, is set for hearing in September. Federal court is the preferred jurisdiction so defendants will vigorously oppose the remand. Discovery has not yet begun as several defendants have not made appearances. According to the complaint, each of the pharmaceutical companies manufactured or distributed the drugs oxycodone, hydrocodone and/or OxyContin. The complaint alleges that the defendants failed to adequately warn physicians and their patients of the dangers involved with these drugs and that as a result of this failure to warn, plaintiffs suffered injury. EPI intends to defend itself vigorously in this case.

General

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

Item 2. ***Changes in Securities and Use of Proceeds.***

None.

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

None.

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

(a) The annual meeting of the stockholders of the Company was held on May 28, 2003.

(b) The stockholders elected all of the Company s nominees for director. The stockholders also approved the appointment of Deloitte & Touche LLP as the Company s independent auditors for 2003.

(1) *Election of Directors:*

	For	Against
Carol A. Ammon	99,063,770	0
Brian T. Clingen	99,063,770	0
Michael B. Goldberg	99,063,770	0
Michael Hyatt	99,063,770	0
Roger H. Kimmel	99,063,770	0
Frank J. Loverro	99,063,770	0
Clive A. Meanwell, M.D., Ph.D.	99,063,770	