WATSON PHARMACEUTICALS INC
Form 10-Q
May 01, 2009

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

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009
or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission file number 001-13305

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

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

311 Bonnie Circle
Corona, CA 92880-2882
(Address of principal executive offices, including zip code)
(951) 493-5300
(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
The number of shares outstanding of the Registrant s only class of common stock as of April 27, 2009 was approximately 105,412,000.

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WATSON PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited; in millions)

	March 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 559.0	$ 507.6
Marketable securities	11.8	13.2
Accounts receivable, net	353.6	305.0
Inventories, net	476.2	473.1
Prepaid expenses and other current assets	49.3	48.5
Deferred tax assets	113.9	111.0
Total current assets	1,563.8	1,458.4
Property and equipment, net	649.0	658.5
Investments and other assets	81.2	80.6
Deferred tax assets	42.8	52.3
Product rights and other intangibles, net	546.0	560.0
Goodwill	868.1	868.1
Total assets	$ 3,750.9	$ 3,677.9
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 382.8	$ 381.3
Income taxes payable	22.2	15.5
Short-term debt and current portion of long-term debt	626.4	53.2
Deferred revenue	22.0	16.1
Deferred tax liabilities	89.2	15.9
Total current liabilities	1,142.6	482.0
Long-term debt	250.0	824.7
Deferred revenue	31.1	30.1
Other long-term liabilities	5.0	4.9
Other taxes payable	58.1	53.3
Deferred tax liabilities	100.5	174.3
Total liabilities	1,587.3	1,569.3
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	0.4	0.4
Additional paid-in capital	1,004.1	995.9
Retained earnings	1,467.2	1,418.1
Accumulated other comprehensive loss	(3.3)	(3.2)

Treasury stock, at cost	(304.8)	(302.6)
Total stockholders equity	2,163.6	2,108.6
Total liabilities and stockholders equity	$ 3,750.9	$ 3,677.9

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2009	**2008**
Net revenues	$ 667.4	$ 626.9
Cost of sales (excludes amortization, presented below)	388.7	380.1
Gross profit	278.7	246.8
Operating expenses:		
Research and development	42.3	38.0
Selling and marketing	65.7	56.1
General and administrative	68.9	50.5
Amortization	21.8	20.2
Gain on asset sales	(1.5)	
Total operating expenses	197.2	164.8
Operating income	81.5	82.0
Non-operating (expense) income:		
Loss on early extinguishment of debt		(1.1)
Interest income	2.0	2.3
Interest expense	(4.7)	(6.8)
Other income	1.2	5.4
Total other expense, net	(1.5)	(0.2)
Income before income taxes	80.0	81.8
Provision for income taxes	30.9	31.2
Net income	$ 49.1	$ 50.6
Earnings per share:		
Basic	$ 0.48	$ 0.49
Diluted	$ 0.43	$ 0.45
Weighted average shares outstanding:		
Basic	103.1	102.6

Diluted	118.2	117.4

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in millions)

	Three Months Ended March 31,	
	2009	**2008**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 49.1	$ 50.6
Reconciliation to net cash provided by operating activities:		
Depreciation	23.2	21.8
Amortization	21.8	20.2
Deferred income tax provision	5.7	6.4
Provision for inventory reserve	12.3	9.1
Restricted stock and stock option compensation	4.5	4.3
Earnings on equity method investments	(2.2)	(4.0)
Loss (gain) on securities	1.1	(1.4)
Loss on early extinguishment of debt		1.1
Gain on asset sales	(1.5)	
Other	(0.1)	1.6
Changes in assets and liabilities:		
Accounts receivable, net	(48.6)	(6.2)
Inventories	(15.3)	(39.8)
Prepaid expenses and other current assets	(0.8)	12.8
Accounts payable and accrued expenses	1.5	(26.1)
Deferred revenue	6.8	(8.6)
Income taxes payable	10.8	24.3
Other assets	1.2	0.5
Total adjustments	20.4	16.0
Net cash provided by operating activities	69.5	66.6
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(15.3)	(18.3)
Acquisition of product rights	(7.8)	(0.2)
Proceeds from sale of fixed assets	3.0	
Proceeds from sale of marketable securities	2.2	1.6
Additions to marketable securities		(1.3)
Net cash used in investing activities	(17.9)	(18.2)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on debt and other long-term liabilities	(1.6)	(88.1)
Proceeds from issuance of short-term debt and other long-term liabilities		9.1

Repurchase of common stock	(2.2)	(0.1)
Proceeds from stock plans	3.6	0.1
Net cash used in financing activities	(0.2)	(79.0)
Net increase (decrease) in cash and cash equivalents	51.4	(30.6)
Cash and cash equivalents at beginning of period	507.6	204.6
Cash and cash equivalents at end of period	$ 559.0	$ 174.0

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 GENERAL

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

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

Comprehensive Income

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

	Three Months Ended March 31,	
	2009	**2008**
Net income	$ 49.1	$ 50.6
Other comprehensive loss:		
Translation (losses) gains	(1.3)	0.3
Unrealized loss on securities, net of tax	(0.2)	
Reclassification for losses included in net income, net of tax	1.4	
Unrealized loss on cash flow hedge, net of tax		(1.3)
Total other comprehensive loss	(0.1)	(1.0)
Total comprehensive income	$ 49.0	$ 49.6

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Preferred and Common Stock

As of March 31, 2009 and December 31, 2008 there were 2,500,000 shares of no par value per share preferred stock authorized, with none issued. As of March 31, 2009 and December 31, 2008, there were 500,000,000 shares of $0.0033 par value per share common stock authorized, with 114,945,000 and 114,095,000 shares issued and 105,380,000 and 104,608,000 outstanding, respectively. Of the issued shares, 9,565,000 and 9,487,000 shares were held as treasury shares as of March 31, 2009 and December 31, 2008, respectively.

Provisions for Sales Returns and Allowances

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

The provision for chargebacks is our most significant sales allowance. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to the Company by our wholesale customer for a particular product and the negotiated contract price that the wholesaler s customer pays for that product. The Company s chargeback provision and related reserve vary with changes in product mix, changes in customer pricing and changes to estimated wholesaler inventories. The provision for chargebacks also takes into account an estimate of the expected wholesaler sell-through levels to indirect customers at contract prices. The Company validates the chargeback accrual quarterly through a review of the inventory reports obtained from our largest wholesale customers. This customer inventory information is used to verify the estimated liability for future chargeback claims based on historical chargeback and contract rates. These large wholesalers represent 85% - 90% of the Company s chargeback payments. The Company continually monitors current pricing trends and wholesaler inventory levels to ensure the liability for future chargebacks is fairly stated.

Net revenues and accounts receivable balances in the Company s condensed consolidated financial statements are presented net of SRA estimates. Certain SRA balances are included in accounts payable and accrued liabilities. Accounts receivable are presented net of SRA balances of $271.4 million and $285.7 million at March 31, 2009 and December 31, 2008, respectively. Accounts payable and accrued liabilities include $44.4 million and $42.4 million at March 31, 2009 and December 31, 2008, respectively, for certain rebates and other amounts due to indirect customers.

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

	Chargebacks	Rebates	Returns and Other Allowances	Cash Discounts	Total
Balance at December 31, 2007	$ 164.4	$ 154.3	$ 56.1	$ 12.9	$ 387.7
Provision related to sales in three months ended March 31, 2008	313.9	78.5	45.1	16.6	454.1
Credits and payments	(323.2)	(86.0)	(38.4)	(14.3)	(461.9)
Balance at March 31, 2008	155.1	146.8	62.8	15.2	379.9
Provision related to sales in three quarters ended December 31, 2008	910.1	230.6	134.7	50.6	1,326.0
Credits and payments	(944.6)	(251.6)	(128.0)	(53.5)	(1,377.7)
Balance at December 31, 2008	120.6	125.8	69.5	12.3	328.2
Provision related to sales in three months ended March 31, 2009	275.2	88.3	47.3	17.3	428.1
Credits and payments	(289.2)	(96.2)	(39.8)	(15.3)	(440.5)
Balance at March 31, 2009	$ 106.6	$ 117.9	$ 77.0	$ 14.3	$ 315.8

Earnings Per Share (EPS)

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

	Three months ended March 31,	
	2009	2008
EPS basic		
Net income	$ 49.1	$ 50.6
Basic weighted average common shares outstanding	103.1	102.6
EPS basic	$ 0.48	$ 0.49

EPS diluted		
Net income	$ 49.1	$ 50.6
Add: Interest expense on CODES, net of tax	1.9	2.0
Net income, adjusted	$ 51.0	$ 52.6
Basic weighted average common shares outstanding	103.1	102.6
Effect of dilutive securities:		
Conversion of CODES	14.4	14.4
Dilutive stock options	0.7	0.4
Diluted weighted average common shares outstanding	118.2	117.4
EPS diluted	$ 0.43	$ 0.45

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Stock awards to purchase 6.0 million and 9.0 million common shares for the three month periods ended March 31, 2009 and 2008, respectively, were outstanding but were not included in the computation of diluted earnings per share because the options were antidilutive.

Share-Based Compensation

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

As of March 31, 2009, the Company had $3.0 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock option grants, which will be recognized over the remaining weighted average period of 1.4 years. As of March 31, 2009, the Company had $28.8 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock grants, which will be recognized over the remaining weighted average period of 2.2 years. During the three months ended March 31, 2009, the Company issued approximately 782,000 restricted stock grants with an aggregate intrinsic value of $21.9 million. No stock option grants were issued during the three months ended March 31, 2009.

Recent Accounting Pronouncements

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

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141R) which replaces SFAS No. 141, Business Combinations . SFAS 141R establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in a business combination at their fair value at acquisition date. SFAS 141R alters the treatment of acquisition-related costs, business combinations achieved in stages (referred to as a step acquisition), the treatment of gains from a bargain purchase, the recognition of contingencies in business combinations, the treatment of in-process research and development in a business combination as well as the treatment of recognizable deferred tax benefits. SFAS 141R is effective for business combinations closed in fiscal years beginning after December 15, 2008. As SFAS 141R is applicable to business acquisitions completed after January 1, 2009 and the Company did not have any business acquisitions during the quarter ended March 31, 2009, the adoption of SFAS 141R did not have a material impact on the Company s condensed consolidated financial statements.

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

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In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133, (SFAS 161). SFAS 161 requires enhanced disclosures about a company s derivative and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of SFAS 161 did not have a material impact on the Company s condensed consolidated financial statements.

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

NOTE 2 OTHER INCOME

Other income consisted of the following (in millions):

	Three Months Ended March 31,	
	2009	**2008**
Earnings on equity method investments	$ 2.2	$ 4.0
(Loss) gain on securities	(1.1)	1.4
Other income	0.1	
	$ 1.2	$ 5.4

NOTE 3 OPERATING SEGMENTS

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

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

	Three Months Ended March 31, 2009				Three Months Ended March 31, 2008			
	Generic	Brand	Distribution	Total	Generic	Brand	Distribution	Total
Product sales	$ 395.2	$ 98.2	$ 153.7	$ 647.1	$ 342.4	$ 99.0	$ 144.9	$ 586.3
Other	6.5	13.8		20.3	24.3	16.3		40.6
Net revenues	401.7	112.0	153.7	667.4	366.7	115.3	144.9	626.9
Cost of sales(1)	238.5	24.2	126.0	388.7	229.7	27.5	122.9	380.1
Gross profit(1)	163.2	87.8	27.7	278.7	137.0	87.8	22.0	246.8
Gross margin(1)	40.6%	78.4%	18.0%	41.8%	37.4%	76.1%	15.2%	39.4%
Research and development	30.1	12.2		42.3	22.6	15.4		38.0
Selling and marketing	12.7	36.9	16.1	65.7	14.1	28.0	14.0	56.1
Contribution	$ 120.4	$ 38.7	$ 11.6	170.7	$ 100.3	$ 44.4	$ 8.0	152.7
Contibution margin	30.0%	34.6%	7.5%	25.6%	27.4%	38.5%	5.5%	24.4%
General and administrative				68.9				50.5
Amortization				21.8				20.2
Gain on asset sales				(1.5)				
Operating income				$ 81.5				$ 82.0
Operating margin				12.2%				13.1%

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

NOTE 4 INVENTORIES

Inventories consist of finished goods held for sale and distribution, raw materials and work-in-process. Included in inventory at March 31, 2009 and December 31, 2008 is approximately $19.7 million and $16.4 million, respectively, of inventory that is pending approval by the U.S. Food and Drug Administration (FDA) or has not been launched due to contractual restrictions. This inventory consists primarily of generic pharmaceutical products that are capitalized only when the bioequivalence of the product is demonstrated or the product is already FDA approved and is awaiting a contractual triggering event to enter the marketplace.

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

	March 31, 2009	December 31, 2008
Inventories:		
Raw materials	$ 131.5	$ 109.1
Work-in-process	61.2	44.2
Finished goods	328.8	354.5
	521.5	507.8
Less: Inventory reserves	45.3	34.7
Inventories, net	$ 476.2	$ 473.1

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NOTE 5 DEBT

Debt consisted of the following (in millions):

	March 31, 2009	December 31, 2008
Senior Credit Facility, due 2011, bearing interest at LIBOR plus 0.75% (2006 Credit Facility)	$ 300.0	$ 300.0
CODES, face amount of $575 million, due 2023, net of unamortized discount	574.8	574.7
Other notes payable	1.6	3.2
	876.4	877.9
Less: Current portion	626.4	53.2
Total long-term debt	$ 250.0	$ 824.7

Senior Credit Facility

During the quarter ended March 31, 2009, the CODES debt was reclassified to current liabilities from long-term liabilities as it is our expectation that the CODES holders will exercise a March 15, 2010 put option, as defined under the terms of the CODES, which will require the Company to repurchase the outstanding amount of the CODES for cash. For additional information regarding the terms of the CODES, refer to NOTE 9 Long-Term Debt of our Annual Report on Form 10-K for the year ended December 31, 2008.

During the three months ended March 31, 2008, the Company made prepayments of the 2006 Credit Facility totaling $75.0 million. As a result of this pre-payment, the Company s results for the three months ended March 31, 2008 reflect a $1.1 million charge for losses on the early extinguishment of debt. As of March 31, 2009, $300.0 million is outstanding under the 2006 Credit Facility. The full amount outstanding on the 2006 Credit Facility is due November 2011.

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NOTE 6 BUSINESS RESTRUCTURING CHARGES

During the first quarter of 2008, the Company announced efforts to reduce its cost structure through its Global Supply Chain Initiative, which includes the planned closure of manufacturing facilities in Carmel, New York, its distribution center in Brewster, New York and the transition of manufacturing to our other manufacturing locations within the U.S. and India. While the final closing date will depend on a number of factors, we anticipate the successful transition of product manufacturing and the completion of related facility rationalization activities will permit the closure of these facilities by the end of 2010. Activity related to our Global Supply Chain Initiative restructuring and facility rationalization activities for the three months ended March 31, 2009 consisted of the following:

(in millions)	Balance at December 31, 2008	Charged to Expense	Cash Payments	Non-cash Adjustments	Accrual Balance at March 31, 2009
Cost of sales					
Severance and retention	$ 13.7	$ 3.2	$ (0.3)	$	$ 16.6
Product transfer costs	0.7	2.2	(1.3)		1.6
Facility decommission costs	0.2	0.1	(0.1)		0.2
Accelerated depreciation		1.8		(1.8)	
	14.6	7.3	(1.7)	(1.8)	18.4
Operating expenses					
Research and development	0.7	1.5	(0.7)		1.5
Selling, general and administrative	0.8	0.5	(0.1)		1.2
	1.5	2.0	(0.8)		2.7
Total restructuring charges	$ 16.1	$ 9.3	$ (2.5)	$ (1.8)	$ 21.1

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

Through the end of March, 2009, the Company has recognized total charges of $39.7 million related to our Global Supply Chain Initiative. The Company expects to incur pre-tax costs associated with our Global Supply Chain Initiative of approximately $60.0 to $70.0 million which includes accelerated depreciation expense of $25.0 to $30.0 million, severance, retention, relocation and other employee related costs of approximately $25.0 to $30.0 million and product transfer costs of approximately $8.0 to $12.0 million.

NOTE 7 INCOME TAXES

The Company s effective tax rate for the three months ended March 31, 2009 was 38.6% compared to 38.1% for the three months ended March 31, 2008. The higher effective tax rate for the three months ended March 31, 2009, as compared to the same period of the prior year, primarily reflects the impact of a California state legislative change in the current quarter which was partially offset by a reduction in the effective tax rate for the R&D tax credit and certain

permanent differences.

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

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

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NOTE 8 STOCKHOLDERS EQUITY

A summary of the changes in stockholders equity for the three months ended March 31, 2009 consisted of the following (in millions):

Stockholders equity, December 31, 2008	$ 2,108.6
Common stock issued under employee plans	3.6
Increase in additional paid-in capital for share-based compensation plans	4.5
Net income	49.1
Other comprehensive loss	(0.1)
Tax benefit from employee stock plans	0.1
Repurchase of common stock	(2.2)
Stockholders equity, March 31, 2009	$ 2,163.6

NOTE 9 FAIR VALUE MEASUREMENT

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

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

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

	Fair Value Measurements as at March 31, 2009 Using:			
	Total	Level 1	Level 2	Level 3
Marketable securities	$ 11.8	$ 11.8	$	$
Investments	0.1	0.1		

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

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

NOTE 10 CONTINGENCIES

Legal Matters

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

Cipro® Litigation. Beginning in July 2000, a number of suits were filed against Watson, The Rugby Group, Inc. (Rugby) and other company affiliates in various state and federal courts alleging claims under various federal and state competition and consumer protection laws. Several plaintiffs have filed amended complaints and motions seeking class certification. Approximately 42 cases had been filed against Watson, Rugby and other Watson entities. Twenty-two of these actions have been consolidated in the U.S. District Court for the Eastern District of New York (*In re: Ciprofloxacin Hydrochloride Antitrust Litigation, MDL Docket No. 001383*). On May 20, 2003, the court hearing the consolidated action granted Watson s motion to dismiss and made rulings limiting the theories under which plaintiffs can seek recovery against Rugby and the other defendants. On March 31, 2005, the court hearing the consolidated action granted summary judgment in favor of the defendants on all of plaintiffs claims, denied the plaintiffs motions for class certification, and directed the clerk of the court to close the case. On May 7, 2005, three groups of plaintiffs from the consolidated action (the direct purchaser plaintiffs, the indirect purchaser plaintiffs and plaintiffs Rite Aid and CVS) filed notices of appeal in the United States Court of Appeals for the Second Circuit, appealing, among other things, the May 20, 2003 order dismissing

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Watson and the March 31, 2005 order granting summary judgment in favor of the defendants. The three appeals were consolidated by the appellate court. On August 25, 2005, the defendants moved to transfer the appeals to the United States Court of Appeals for the Federal Circuit on the ground that patent issues are involved in the appeal. On November 7, 2007, the motions panel of the U.S. Court of Appeals for the Second Circuit granted the motion in part, and ordered the appeal by the indirect purchaser plaintiffs transferred to the United States Court of Appeals for the Federal Circuit. On October 15, 2008, the United States Court of Appeals for the Federal Circuit affirmed the dismissal of the indirect purchasers claims, and on December 22, 2008, denied the indirect purchaser plaintiffs petition for rehearing and rehearing en banc. On March 23, 2009, the indirect purchaser plaintiffs filed a petition for writ of certiorari with the United States Supreme Court. The appeal in the United States Court of Appeals for the Second Circuit by the direct purchaser plaintiffs and plaintiffs CVS and Riteaid remains pending. Other actions are pending in various state courts, including New York, California, Kansas, Tennessee, and Florida. The actions generally allege that the defendants engaged in unlawful, anticompetitive conduct in connection with alleged agreements, entered into prior to Watson s acquisition of Rugby from Sanofi Aventis (Aventis), related to the development, manufacture and sale of the drug substance ciprofloxacin hydrochloride, the generic version of Bayer s brand drug, Cipro®. The actions generally seek declaratory judgment, damages, injunctive relief, restitution and other relief on behalf of certain purported classes of individuals and other entities. The court hearing the case in New York has dismissed the action. Appellants have sought leave to appeal the dismissal of the New York action to the New York Court of Appeals. On April 18, 2006, the New York Supreme Court, Appellate Division, denied the appellants motion. In the action pending in Kansas, the court has stayed the matter pending the outcome of the appeal in the consolidated case. In the action pending in the California Superior Court for the County of San Diego (*In re: Cipro Cases I & II, JCCP Proceeding Nos. 4154 & 4220*), on July 21, 2004, the California Court of Appeal granted in part and denied in part the defendants petition for a writ of mandate seeking to reverse the trial court s order granting the plaintiffs motion for class certification. Pursuant to the appellate court s ruling, the majority of the plaintiffs will be permitted to pursue their claims as a class. The parties intend to file motions for summary judgment, which are scheduled to be argued to the Superior Court during the third quarter of 2009. The trial is scheduled for January 24, 2010. In addition to the pending actions, Watson understands that various state and federal agencies are investigating the allegations made in these actions. Aventis has agreed to defend and indemnify Watson and its affiliates in connection with the claims and investigations arising from the conduct and agreements allegedly undertaken by Rugby and its affiliates prior to Watson s acquisition of Rugby, and is currently controlling the defense of these actions.

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

Beginning in July 2002, the Company and certain of its subsidiaries, as well as numerous other pharmaceutical companies, were named as defendants in various state and federal court actions alleging improper

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or fraudulent reporting practices related to the reporting of average wholesale prices and wholesale acquisition costs of certain products, and that the defendants committed other improper acts in order to increase prices and market shares. Some of these actions have been consolidated in the U.S. District Court for the District of Massachusetts (*In re: Pharmaceutical Industry Average Wholesale Price Litigation, MDL Docket No. 1456*). The consolidated amended Class Action complaint in that case alleges that the defendants acts improperly inflated the reimbursement amounts paid by various public and private plans and programs. The amended complaint alleges claims on behalf of a purported class of plaintiffs that paid any portion of the price of certain drugs, which price was calculated based on its average wholesale price, or contracted with a pharmacy benefit manager to provide others with such drugs. The Company filed an Answer to the Amended Consolidated Class Action Complaint on April 9, 2004. Defendants in the consolidated litigation have been divided into two groups. Certain defendants, referred to as the Track One defendants, have proceeded on an expedited basis. Classes were certified against these defendants, a trial has been completed with respect to some of the claims against this group of defendants, the presiding judge has issued a ruling granting judgment to the plaintiffs, that judgment is being appealed, and many of the claims have been settled. Other defendants, referred to as the Track Two Defendants , including the Company, have entered into a settlement agreement resolving all claims against the Track Two Defendants in the Consolidated Class Action. The total amount of the settlement for all of the Track Two Defendants is $125 million. The amount to be paid by each Track Two Defendant is confidential. On July 2, 2008, the United States District Court for the District of Massachusetts preliminarily approved the Track Two settlement. On April 27, 2009, the Court held a hearing to further consider the fairness of the proposed Track Two settlement. The Court adjourned the hearing without ruling on the fairness of the proposed settlement until additional notices are provided to certain of the class members in the action. The settlement is not expected to materially adversely affect the Company s business, results of operations, financial condition and cash flows.

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

Alpharma Inc., et al, Case No. 08-001565, in the District Court of Travis County, Texas; and United States of America ex rel. Ven-A-Care of the Florida Keys, Inc., Civil Action No. 08-10852, in the U.S. District Court for the District of Massachussetts and State of Kansas ex rel. Steve Six v. Watson Pharmaceuticals, Inc. and Watson Pharma, Inc., Case Number: 08CV2228, District Court of Wyandotte County, Kansas, Civil Court Department.

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

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

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

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

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

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FDA s applicable cGMP requirements, applicable FDA regulatory guidance, and the collective knowledge, education, qualifications and experience of the expert s auditors and reviewers, the systems at Watson s Corona facility audited and evaluated by the expert are in compliance with the FDA s cGMP regulations. However, the FDA is not required to accept or agree with the independent expert s opinion. The FDA conducted an inspection of that facility from March 31, 2004 until May 6, 2004. At the conclusion of the inspection, the FDA issued a Form 483 listing the observations made during the inspection, including observations related to certain laboratory test methods and other procedures in place at the facility. In June 2004 the Company submitted its response to the FDA Form 483 inspectional observations and met with FDA officials to discuss its response, including the corrective actions the Company had taken, and intended to take, to address the inspectional observations. The FDA conducted another inspection of the facility from April 5, 2005 through April 13, 2005. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. The FDA conducted another inspection of the facility from July 9, 2006 through July 21, 2006. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. From February 20, 2007 through March 9, 2007, the FDA conducted another inspection of the facility. At the conclusion of the inspection, the FDA issued a Form 483 listing the observations made during the inspection. In April 2007 the Company submitted its response to the FDA Form 483 inspectional observations, including the corrective actions the Company has taken to address the inspectional observations. The FDA conducted another inspection of the facility from October 18, 2007 through October 26, 2007. At the conclusion of the inspection, the FDA issued a Form 483 listing two observations made during the pre-approval portion of the inspection related to two pending Abbreviated New Drug Applications (ANDAs). No formal observations were made concerning the Company s compliance with cGMP. The FDA conducted another inspection of the facility from June 16, 2008 through June 27, 2008. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. However, if in the future, the FDA determines that, with respect to its Corona facility, Watson has failed to comply with the consent decree or FDA regulations, including cGMPs, or has failed to adequately address the observations in the Form 483, the consent decree allows the FDA to order Watson to take a variety of actions to remedy the deficiencies. These actions could include ceasing manufacturing and related operations at the Corona facility, and recalling affected products. Such actions, if taken by the FDA, could have a material adverse effect on the Company, its results of operations, financial position and/or cash flows.

Naproxen Sodium (Naprelan). In October 1998, Elan Corporation Plc sued Andrx in the United States District Court for the Southern District of Florida, alleging that Andrx s pending ANDA for a generic version of Elan s Naprelan® infringed Elan s patent No. 5,637,320 (the 320 Patent) (*Elan Corporation PLC v. Andrx Pharmaceuticals, Inc., Case No. 98-7164*). In March 2002, the District Court issued an order that the asserted claims of Elan s patent were invalid, and in September 2002, Andrx commenced selling the 500mg strength of naproxen sodium, its generic version of Naprelan®. In March 2003, the District Court issued an order denying, among other things, (i) Elan s motion for consideration of the March 2002 order invalidating its patent, and (ii) Andrx s motion asking the District Court for a ruling on its non-infringement defenses. Both parties appealed that March 2003 decision (*Elan Corporation PLC v. Andrx Pharmaceuticals, Inc., Case No. 03-1354*) to the United States Court of Appeals for the Federal Circuit. On May 5, 2004, the Federal Circuit Court of Appeals reversed the District Court s determination that the asserted claims of the Elan patent were invalid, and remanded the case back to the District Court for a determination as to whether Andrx s product infringes the Elan patent, whether the asserted claims were invalid on other grounds, and whether the patent was enforceable. In January 2005, Elan filed a separate complaint in the U.S. District Court for the Southern District of Florida seeking damages as a result of Andrx s sale of its generic version of Naprelan® (*Elan Corporation PLC v. Andrx Pharmaceuticals, Inc., Case No. 058-60158*). On July 12, 2005, the Federal Circuit Court of Appeals issued a decision, in an unrelated case, on how a court should address issues of claim construction. At the instruction of the District Court, the parties filed briefs on how the District Court should proceed in this matter in light of the Federal Circuit Court of Appeals opinion regarding the proper approach to claim construction. On August 13, 2008, the District Court ruled that the Company s naproxen sodium product infringes Elan s patent No. 5,637,320, and that the infringement was willful and that the asserted claims were not invalid or otherwise unenforceable. The Company voluntarily discontinued sales of its naproxen sodium product on August 13, 2008. On March 6, 2009, the Company entered into a settlement agreement and release agreement in full settlement of all disputes related to the Company s

development, manufacturing, marketing and sale of its naproxen sodium product. Under the settlement agreement, the Company paid $18 million to Elan, and agreed not to market or sell its naproxen sodium product until the expiration or final finding of invalidity or unenforceability of the 320 Patent.

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

Androgel® Antitrust Litigation. On January 29, 2009, the U.S. Federal Trade Commission and the State of California filed a lawsuit in the United States District Court for the Central District of California (*Federal Trade Commission, et. al. v. Watson Pharmaceuticals, Inc., et. al., USDC Case No. CV 09-00598)* alleging that the Company s September 2006 patent lawsuit settlement with Solvay Pharmaceuticals, Inc., related to AndroGel® 1% (testosterone gel) CIII is unlawful. The complaint generally alleges that the Company improperly delayed its launch of a generic version of Androgel® in exchange for Solvay s agreement to permit the Company to co-promote Androgel® for consideration in excess of the fair value of the services provided by the Company. The complaint alleges violation of federal and state antitrust and consumer protection laws and seeks equitable relief and civil penalties. On February 2 and 3, 2009, three separate lawsuits alleging similar claims were filed in the United States District Court for the Central District of California by various private plaintiffs purporting to represent certain classes of similarly situated claimants. *(Meijer, Inc., et. al., v. Unimed Pharmaceuticals, Inc., et. al., USDC Case No. EDCV 09-0215); (Rochester Drug Co-Operative, Inc. v. Unimed Pharmaceuticals Inc., et. al., Case No. EDCV 09-0226); (Louisiana Wholesale Drug Co. Inc. v. Unimed Pharmaceuticals Inc., et. al, Case No. EDCV 09-0228).* On February 27, 2009, the defendants (including the Company) filed motions to transfer all of the actions pending in the United States District Court for the Central District of California to the United States District Court for the Northern District of Georgia. On April 8, 2009, the Court granted the defendants motion to transfer and transferred the cases to the Northern District of Georgia. On April 21, 2009 the State of California voluntarily dismissed its lawsuit against the Company without prejudice. On March 31, April 17, and April 21, 2009, additional actions alleging similar claims were filed in the United States District Court for the District of New Jersey (*Stephen L. LaFrance Pharm., Inc. d/b/a SAJ Dist. v. Unimed Pharms., Inc., et al., Civ. No. 09-1507*); (*Fraternal Order of Police, Fort Lauderdale Lodge 31, Insurance Trust Fund v. Unimed Pharms. Inc., et al., Civ. No. 09-1856*); (*Scurto v. Unimed Pharms., Inc., et al., Civ. No. 09-1900*). These actions purport to assert similar claims on behalf of various class representatives. On April 8, 2009, the *Stephen J. LaFrance* plaintiffs filed a motion to have all of the private plaintiff cases consolidated under the Multidistrict Litigation rules of the federal courts. A hearing on that motion is scheduled for May 28, 2009. On April 20, 2009, the Company was dismissed from the *Stephen J. LaFrance* action pending in the District of New Jersey without prejudice. On April 28, 2009, the judge presiding over the Federal Trade Commission action and the private actions in the Northern District of Georgia granted the plaintiffs request to file an amended complaint and invited the Federal Trade Commission to file an amended complaint and otherwise stayed the proceedings. All of these lawsuits are at the pleading stages, and additional actions are anticipated. The Company believes that these actions are without merit and intends to defend itself vigorously. However, these actions, if successful, could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

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

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

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

Ferrlecit®. On March 28, 2008, we received a notice from Aventis contending that the distribution agreement for Ferrlecit® between certain affiliates of Aventis and the Company expires on February 18, 2009. The letter also acknowledged the Company s position that the distribution agreement expires on December 31, 2009, and requested to conduct an expedited arbitration proceeding to resolve the dispute. By its terms, the distribution agreement, as amended, has a duration of ten (10) full calendar years after FDA market approval. Ferrlecit® received FDA market approval on February 18, 1999. On April 9, 2008, the Company responded to Aventis, agreeing to arbitrate the disputes related to Ferrlecit® on an expedited basis. In addition to a declaration that the distribution agreement expires on February 18, 2009, Aventis is seeking damages for any sales of Ferrlecit® by the Company after February 18, 2009. The arbitration is pending and a decision is expected in May 2009. Additionally, the parties are continuing to discuss a possible extension of the distribution agreement and related agreements beyond 2009. However, there can be no assurance that we will be able to negotiate extensions of these agreements on commercially reasonable terms, or at all. Our inability to negotiate extensions of these agreements on commercially reasonable terms, or an adverse finding in the pending arbitration proceeding, could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

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

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

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

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

Overview

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

Results of Operations

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

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

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

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Three Months Ended March 31, 2009 Compared to Three Months Ended March 31, 2008

	Three Months Ended March 31, 2009				Three Months Ended March 31, 2008			
($ in millions):	Generic	Brand	Distribution	Total	Generic	Brand	Distribution	Total
Product sales	$ 395.2	$ 98.2	$ 153.7	$ 647.1	$ 342.4	$ 99.0	$ 144.9	$ 586.3
Other	6.5	13.8		20.3	24.3	16.3		40.6
Net revenues	401.7	112.0	153.7	667.4	366.7	115.3	144.9	626.9
Cost of sales(1)	238.5	24.2	126.0	388.7	229.7	27.5	122.9	380.1
Gross profit(1)	163.2	87.8	27.7	278.7	137.0	87.8	22.0	246.8
Gross margin(1)	40.6%	78.4%	18.0%	41.8%	37.4%	76.1%	15.2%	39.4%
Research and development	30.1	12.2		42.3	22.6	15.4		38.0
Selling and marketing	12.7	36.9	16.1	65.7	14.1	28.0	14.0	56.1
Contribution	$ 120.4	$ 38.7	$ 11.6	170.7	$ 100.3	$ 44.4	$ 8.0	152.7
Contibution margin	30.0%	34.6%	7.5%	25.6%	27.4%	38.5%	5.5%	24.4%
General and administrative				68.9				50.5
Amortization				21.8				20.2
Gain on asset sales				(1.5)				
Operating income				$ 81.5				$ 82.0
Operating margin				12.2%				13.1%

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

Generic Segment

Net Revenues

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

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

Other revenues consist primarily of royalties and commission revenue.

Net revenues from our Generic segment for the three months ended March 31, 2009 increased 9.5% or $35.0 million to $401.7 million compared to net revenues of $366.7 million from the prior year period. This increase in sales was mainly attributable to new product launches and products acquired subsequent to the first quarter of 2008 ($57.2 million) offset in part by a decrease in other revenue ($17.8 million).

The decrease in other revenues in the three months ended March 31, 2009 for the Generic segment was primarily related to reduced royalties on sales by Sandoz, Inc. of metoprolol succinate 50 mg extended release tablets and reduced royalties on sales by GlaxoSmithKline of Wellbutrin XL® 150 mg. Sales of metoprolol

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succinate 50 mg declined as Sandoz, Inc. ceased shipping the product in the fourth quarter of 2008 and it is uncertain when sales will resume. Sales of Wellbutrin XL® 150 mg declined due to increased competition. Both items combined resulted in a reduction in royalties in the quarter totaling $15.8 million.

Gross Profit (Gross Margin)

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

Gross profit for our Generic segment increased $26.2 million to $163.2 million in the three months ended March 31, 2009 compared to $137.0 million in the prior year period. The increase in gross profit was primarily due to new product launches and recent product acquisitions ($29.5 million), a reduction in costs associated with our Global Supply Chain Initiative over the prior year period ($5.6 million), an increase in sales of oral contraceptives and an increase in gross profit due to a favorable product mix. These increases were partially offset by a decrease in other revenue ($17.8 million).

Gross margins for our Generic segment increased 3.2 percentage points to 40.6% for the three months ended March 31, 2009 from 37.4% in the prior year period. This increase in gross margin was primarily related to higher overall margins on new product launches and recent product acquisitions.

Research and Development Expenses

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

Generic segment R&D expenses increased 33.0% or $7.5 million to $30.1 million in the three months ended March 31, 2008 compared to $22.6 million in the prior year period due to higher biostudy and test chemical costs ($5.4 million) and Global Supply Chain Initiative severance costs in the current year period ($1.5 million).

Selling and Marketing Expenses

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

Generic segment selling and marketing expenses decreased 9.5% or $1.4 million to $12.7 million in the three months ended March 31, 2009 compared to $14.1 million in the prior year period.

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Brand Segment

Net Revenues

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

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

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

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

Net revenues from our Brand segment for the three months ended March 31, 2009 decreased 2.8% or $3.3 million to $112.0 million compared to net revenues of $115.3 million in the prior year period. The decrease was primarily attributable to lower other revenues ($2.4 million) and lower sales of INFeD® within the Nephrology/Medical group due to a supply interruption of INFeD® s API which is available from only one source. The INFeD® API supply interruption may continue for the remainder of 2009.

Gross Profit (Gross Margin)

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

Gross profit for our Brand segment was $87.8 million or the same as the prior year period. A decrease in other revenues ($2.4 million) was offset by improved gross profit within the Specialty Product group in the current year period.

Gross margins for our Brand segment increased to 78.4% during the three months ended March 31, 2009 from 76.1% in the prior year period primarily due to improved product mix.

Research and Development Expenses

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

Brand segment R&D expenses decreased 20.5% or $3.2 million to $12.2 million in the three months ended March 31, 2008 compared to $15.4 million in the prior year period primarily due to a $5.0 million milestone payment in the prior year period related to the filing of an NDA for Rapaflo™ with the FDA. This decrease in R&D expenses was partially offset by increased clinical spending on recently approved new products.

Selling and Marketing Expenses

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

Brand segment selling and marketing expenses increased 31.7% or $8.9 million to $36.9 million in the three months ended March 31, 2009 as compared to $28.0 million in the prior year period primarily related to increased product promotion, field force and marketing costs to support pre-launch activities related to Rapaflo™ and Gelnique™.

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Distribution Segment

Net Revenues

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

Net revenues from our Distribution segment for the three months ended March 31, 2009 increased 6.1% or $8.8 million to $153.7 million compared to net revenues of $144.9 million in the prior year period primarily due to an increase in net revenues from new products launched since the first quarter of 2008 ($33.0 million) which was partially offset by lower levels of sales in the current period from price erosion and volume decreases ($24.8 million).

Gross Profit (Gross Margin)

Gross profit for our Distribution segment increased $5.7 million to $27.7 million in the three months ended March 31, 2009 compared to $22.0 million in the prior year period. Gross margins also improved for our Distribution segment increasing to 18.0% during the three months ended March 31, 2009 from 15.2% in the prior year period. Distribution segment gross profit improved in the current quarter due to increased sales levels and higher gross margins. Distribution segment gross margin improved in the current quarter due to lower product acquisition costs and higher pricing on certain products.

Selling and Marketing Expenses

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

Distribution segment selling and marketing expenses increased 14.6% or $2.1 million to $16.1 million in the three months ended March 31, 2009 as compared to $14.0 million in the prior year period primarily related to higher freight costs ($1.0 million) and higher payroll costs ($1.0 million).

Segment Contribution

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	Change %
Segment contribution				
Generic	$ 120.4	$ 100.3	$ 20.1	20.0%
Brand	38.7	44.4	(5.7)	(12.8)%
Distribution	11.6	8.0	3.6	45.0%
	$ 170.7	$ 152.7	$ 18.0	11.8%
as % of net revenues	*25.6%*	*24.4%*		

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

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Corporate General and Administrative Expenses

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Corporate general and administrative expenses	$ 68.9	$ 50.5	$18.4	36.4%
as a % of net revenues	*10.3%*	*8.1%*		

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

Corporate general and administrative expenses increased during the three months ended March 31, 2009 primarily due to an $18.0 million legal settlement of a patent dispute with Elan Corporation, Plc during the current year period.

Amortization

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Amortization	$ 21.8	$ 20.2	$1.6	7.9%
as a % of net revenues	*3.3%*	*3.2%*		

The Company s amortizable assets consist primarily of acquired product rights. For the three months ended March 31, 2009 amortization expense increased $1.6 million primarily as a result of the amortization of product rights the Company acquired in the fourth quarter of 2008 as a result of the merger between Teva Pharmaceutical Industries, Ltd. and Barr Pharmaceuticals, Inc.

Gain on Asset Sales

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Gain on asset sales	$ (1.5)	$	$(1.5)	100.0%
as a % of net revenues	*(0.2)%*	*0.0%*		

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

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Loss on Early Extinguishment of Debt

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Loss on early extinguishment of debt	$	$ 1.1	$(1.1)	(100.0)%
as a % of net revenues	*0.0%*	*0.2%*		

In November 2006, we entered into a Senior Credit Facility with Canadian Imperial Bank of Commerce, acting through its New York agency, as Administrative Agent, Wachovia Capital Markets, LLC, as Syndication Agent, and a syndicate of banks (the 2006 Credit Facility) in connection with the acquisition of the Andrx Corporation.

During the quarter ended March 31, 2008, the Company prepaid $75.0 million of outstanding debt on the 2006 Credit Facility. As a result of this prepayment, our results for the quarter ended March 31, 2008 reflect debt repurchase charges of $1.1 million which consist of unamortized debt issue costs associated with the repurchased amount.

Interest Income

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Interest income	$ 2.0	$ 2.3	$(0.3)	(13.0)%
as a % of net revenues	*0.3%*	*0.4%*		

Interest income decreased for the three months ended March 31, 2009 due to a decrease in interest rates over the prior year period.

Interest Expense

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Interest expense 2006 Credit Facility	$ 1.5	$ 3.9	$ (2.4)	
Interest expense convertible contingent senior debentures due 2023 (CODES)	3.2	3.2		
Interest expense other		(0.3)	0.3	
Interest expense	$ 4.7	$ 6.8	$ (2.1)	(30.9)%
as a % of net revenues	*0.7%*	*1.1%*		

Interest expense decreased for the three months ended March 31, 2009 due to reduced LIBOR rates of interest on the 2006 Credit Facility during the current year period.

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Other Income

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Earnings on equity method investments	$ 2.2	$ 4.0	$ (1.8)	
(Loss) gain on securities	(1.1)	1.4	(2.5)	
Other income	0.1		0.1	
	$ 1.2	$ 5.4	$ (4.2)	(77.8)%
as a % of net revenues	*0.2%*	*0.9%*		

Earnings on Equity Method Investments

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

Scinopharm results for the three months ended March 31, 2008 were higher than the current year period due to product launches during that period.

(Loss) Gain on Securities

For the quarters ended March 31, 2009 and 2008, the Company received contingent proceeds related to the sale of our investment in Adheris, Inc. in 2006.

In the quarter ended March 31, 2009 the Company received cash proceeds of $1.1 million as additional consideration on our sale of our investment in Adheris, Inc. which was recorded as a gain on securities in the quarter. This gain was offset by an other-than-temporary impairment charge of $2.2 million related to our investment in common shares of inVentiv Health, Inc. (inVentiv) as the fair value of our investment fell below our carrying value for a six-month period.

In the quarter ended March 31, 2008 the Company received common shares of inVentiv and cash as additional proceeds on our sale of our investment in Adheris, Inc. which was recorded as a gain on securities in the quarter.

Provision for Income Taxes

($ in millions):	Three Months Ended March 31, 2009	2008	Change Dollars	%
Provision for income taxes	$ 30.9	$ 31.2	$(0.3)	(1.0)%
Effective tax rate	*38.6%*	*38.1%*		

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

The higher effective tax rate for the three months ended March 31, 2009, as compared to the same period of the prior year, primarily reflects the impact of a California state legislative change in the current quarter which was partially offset by a reduction in the effective tax rate for the R&D tax credit and certain permanent differences.

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Liquidity and Capital Resources

Working Capital Position

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

($ in millions):	March 31, 2009	December 31, 2008	Increase (Decrease)
Current Assets:			
Cash and cash equivalents	$ 559.0	$ 507.6	$ 51.4
Marketable securities	11.8	13.2	(1.4)
Accounts receivable, net of allowances	353.6	305.0	48.6
Inventories	476.2	473.1	3.1
Other	163.2	159.5	3.7
Total current assets	1,563.8	1,458.4	105.4
Current liabilities:			
Accounts payable and accrued expenses	382.8	381.3	1.5
Short-term debt and current portion of long-term debt	626.4	53.2	573.2
Other	133.4	47.5	85.9
Total current liabilities	1,142.6	482.0	660.6
Working Capital	$ 421.2	$ 976.4	$ (555.2)
Current Ratio	1.37	3.03	

Watson s primary source of liquidity is cash from operations. Net working capital at March 31, 2009 was $421.2 million, compared to $976.4 million at December 31, 2008. The decline in working capital was due to a reclassification of the CODES debt. During the quarter ended March 31, 2009, the CODES debt was reclassified to current liabilities from long-term liabilities as it is our expectation that the CODES holders will exercise a March 15, 2010 put option, as defined under the terms of the CODES, which will require the Company to repurchase the outstanding amount of the CODES for cash.

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

Cash Flows from Operations

Summarized cash flow from operations is as follows:

($ in millions):	Three months ended March 31, 2009	2008
Net cash provided by operating activities	$ 69.5	$ 66.6

Cash flows from operations represent net income adjusted for certain operations related non-cash items and changes in certain assets and liabilities. For the three months ended March 31, 2009, cash provided by operating activities was $69.5 million, compared to $66.6 million in the three months ended March 31, 2008. The Company has generated cash flows from operating activities primarily driven by net income adjusted for amortization of our

acquired product rights and depreciation.

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Investing Cash Flows

Our cash flows from investing activities are summarized as follows:

($ in millions):	Three months ended March 31, 2009	2008
Net cash used in investing activities	$ 17.9	$ 18.2

Investing cash flows consist primarily of expenditures related to capital expenditures, investment and marketable security additions as well as proceeds from investment and marketable security sales. Net cash used in investing activities for the three months ended March 31, 2009 was relatively unchanged from 2008 levels.

Financing Cash Flows

Our cash flows from financing activities are summarized as follows:

($ in millions):	Three months ended March 31, 2009	2008
Net cash used in financing activities	$ 0.2	$ 79.0

Financing cash flows consist primarily of borrowings and repayments of debt, repurchases of common stock and proceeds from exercising of stock awards. For the three months ended March 31, 2009, net cash used in financing activities was $0.2 million compared to $79.0 million used in financing activities during the three months ended March 31, 2008. Cash used in financing activities was higher in the prior year period due to a $75.0 million prepayment of the 2006 Credit Facility in the three months ended March 31, 2008.

Debt and Borrowing Capacity

Our outstanding debt obligations are summarized as follows:

($ in millions):	March 31, 2009	December 31, 2008	Increase (Decrease)
Short-term debt and current portion of long-term debt	$ 626.4	$ 53.2	$ 573.2
Long-term debt	250.0	824.7	(574.7)
Total debt	$ 876.4	$ 877.9	$ (1.5)
Debt to capital ratio	28.8%	29.4%	

During the quarter ended March 31, 2009, the CODES debt was reclassified to current liabilities from long-term liabilities as it is our current expectation that the CODES holders will exercise a March 15, 2010 put option, as defined under the terms of the CODES, which will require the Company to repurchase the outstanding amount of the CODES for cash.

During the quarter ended March 31, 2008, we prepaid $75.0 million of the amount outstanding under the 2006 Credit Facility. As a result of this prepayment, our results for the first quarter of 2008 reflect a $1.1 million debt repurchase charge. No principal payments are required on the 2006 Credit Facility in 2009. As of March 31, 2009, $50.0 million was outstanding on the revolving credit facility and $250.0 million was outstanding on the senior term loan facility of the 2006 Credit Facility. The full amount outstanding on the 2006 Credit Facility is due November 2011.

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Under the terms of the 2006 Credit Facility, each of our subsidiaries, other than minor subsidiaries, entered into a full and unconditional guarantee on a joint and several basis. We are subject to, and, as of March 31, 2009, were in compliance with financial and operation covenants under the terms of the 2006 Credit Facility. The agreement currently contains the following financial covenants:

maintenance of a minimum net worth of at least $1.53 billion;

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

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

At March 31, 2009, our net worth was $2.16 billion, and our leverage ratio was 1.52 to 1.0. Our interest coverage ratio for the three months ended March 31, 2009 was 22.0 to 1.0.

Under the 2006 Credit Facility, interest coverage ratio, with respect to any financial covenant period, is defined as the ratio of EBITDA for such period to interest expense for such period. The leverage ratio, for any financial covenant period, is defined as the ratio of the outstanding principal amount of funded debt for the borrower and its subsidiaries at the end of such period, to EBITDA for such period. EBITDA under the 2006 Credit Facility, for any covenant period, is defined as net income plus (1) depreciation and amortization, (2) interest expense, (3) provision for income taxes, (4) extraordinary or unusual losses, (5) non-cash portion of nonrecurring losses and charges, (6) other non-operating, non-cash losses, (7) minority interest expense in respect of equity holdings in affiliates, (8) non-cash expenses relating to stock-based compensation expense and (9) any one-time charges related to the Andrx Acquisition; minus (1) extraordinary gains, (2) interest income and (3) other non-operating, non-cash income.

Long-term Obligations

At March 31, 2009, there have been no material changes in the Company s enforceable and legally binding obligations, contractual obligations and commitments from those disclosed in our Annual Report on Form 10-K for the period ended December 31, 2008.

Recent accounting pronouncements

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

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141R) which replaces SFAS No. 141, Business Combinations . SFAS 141R establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed and any noncontrolling interest in a business combination at their fair value at acquisition date. SFAS 141R alters the treatment of acquisition-related costs, business combinations achieved in stages (referred to as a step acquisition), the treatment of gains from a bargain purchase, the recognition of contingencies in business combinations, the treatment of in-process research and development in a business combination as well as the treatment of recognizable deferred tax benefits. SFAS 141R is effective for business combinations closed in fiscal years beginning after December 15, 2008. As SFAS 141R is applicable to business acquisitions completed after

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January 1, 2009 and the Company did not have any business acquisitions during the quarter ended March 31, 2009, the adoption of SFAS 141R did not have a material impact on our condensed consolidated financial statements.

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

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133, (SFAS 161). SFAS 161 requires enhanced disclosures about a company s derivative and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of SFAS 161 did not have a material impact on our condensed consolidated financial statements.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

Investment Risk

As of March 31, 2009, our total holdings in equity securities of other companies, including equity-method investments and available-for-sale securities, were $61.7 million. Of this amount, we had equity-method investments of $60.7 million and publicly traded equity securities (available-for-sale securities) at fair value totaling $0.8 million (included in marketable securities and investments and other assets).

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

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Interest Rate Risk

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

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

Based on quoted market rates of interest and maturity schedules for similar debt issues, we estimate that the fair values of our 2006 Credit Facility and our other notes payable approximated their carrying values on March 31, 2009. As of March 31, 2009, the fair value of our CODES was $14.1 million less than the carrying value. While changes in market interest rates may affect the fair value of our fixed-rate debt, we believe the effect, if any, of reasonably possible near-term changes in the fair value of such debt on our financial condition, results of operations or cash flows will not be material.

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

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

ITEM 4. CONTROLS AND PROCEDURES

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

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

There have been no changes in the Company s internal control over financial reporting, during the three months ended March 31, 2009, that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Quarterly Report, you should carefully consider the risk factors previously disclosed in Item 1A. to Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2008. There were no material changes from these risk factors during the three months ended March 31, 2009.

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

(a) Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities.

(b) Use of Proceeds

N/A.

(c) Issuer Purchases of Equity Securities

During the quarter ended March 31, 2009, the Company repurchased approximately 78,400 shares surrendered to the Company to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees for total consideration of $2.1 million as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicaly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
January 1 - 31, 2009		$		
February 1 - 28, 2009	2,171	$28.27		
March 1 - 31, 2009	76,220	$27.34		

ITEM 6. EXHIBITS

(a) Exhibits:

Reference is hereby made to the Exhibit Index on page 35.

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SIGNATURES

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

WATSON PHARMACEUTICALS, INC.
(Registrant)

By: **/s/ Mark W. Durand**
Mark W. Durand
Senior Vice President Chief Financial Officer (Principal Financial Officer)

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

Date: May 1, 2009

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WATSON PHARMACEUTICALS, INC.
EXHIBIT INDEX TO FORM 10-Q
For the Quarterly Period Ended March 31, 2009

Exhibit No.	Description
31.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14a of the Securities Exchange Act of 1934.
31.2	Certification of Senior Vice President and Chief Financial Officer pursuant to Rule 13a-14a of the Securities Exchange Act of 1934.
32.1	Certification of President and Chief Executive Officer pursuant to Rule 13a-14(d) of the Securities Exchange Act of 1934.
32.2	Certification of Senior Vice President and Chief Financial Officer pursuant to Rule 13a-14(d) of the Securities Exchange Act of 1934.