

WATSON PHARMACEUTICALS INC (WPI)

10-K

Annual report pursuant to section 13 and 15(d)

Filed on 02/22/2011

Filed Period 12/31/2010



THOMSON REUTERS

Westlaw[®] BUSINESS

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

Form 10-K

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

For the fiscal year ended December 31, 2010

OR

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

For the transition period from to

Commission file number 001-13305

WATSON PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

95-3872914

(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.0033 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant 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 file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

Aggregate market value of Common Stock held by non-affiliates of the Registrant, as of June 30, 2010:

\$5,065,021,000 based on the last reported sales price on the New York Stock Exchange

Number of shares of Registrant's Common Stock outstanding on January 31, 2011: 125,827,379

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant's proxy statement for the 2010 Annual Meeting of Stockholders, to be held on May 13, 2011. Such proxy statement will be filed no later than 120 days after the close of the registrant's fiscal year ended December 31, 2010.

WATSON PHARMACEUTICALS, INC.
TABLE OF CONTENTS
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2010

	<u>Page</u>
<u>PART I</u>	
<u>ITEM 1. Business</u>	3
<u>ITEM 1A. Risk Factors</u>	22
<u>ITEM 1B. Unresolved Staff Comments</u>	37
<u>ITEM 2. Properties</u>	38
<u>ITEM 3. Legal Proceedings</u>	39
<u>ITEM 4. [Removed and Reserved]</u>	39
<u>PART II</u>	
<u>ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	40
<u>ITEM 6. Selected Financial Data</u>	42
<u>ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	43
<u>ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	65
<u>ITEM 8. Financial Statements and Supplementary Data</u>	66
<u>ITEM 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	66
<u>ITEM 9A. Controls and Procedures</u>	66
<u>ITEM 9B. Other Information</u>	67
<u>PART III</u>	
<u>ITEM 10. Directors and Executive Officers of the Registrant</u>	67
<u>ITEM 11. Executive Compensation</u>	70
<u>ITEM 12. Security Ownership of Certain Beneficial Owners and Management</u>	70
<u>ITEM 13. Certain Relationships and Related Transactions</u>	70
<u>ITEM 14. Principal Accounting Fees and Services</u>	70
<u>PART IV</u>	
<u>ITEM 15. Exhibits, Financial Statement Schedules</u>	71
<u>SIGNATURES</u>	72
EX-10.2	
EX-21.1	
EX-23.1	
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 LABELS LINKBASE DOCUMENT	
EX-101 PRESENTATION LINKBASE DOCUMENT	
EX-101 DEFINITION LINKBASE DOCUMENT	

PART I

ITEM 1. BUSINESS

Business Overview

Watson Pharmaceuticals, Inc. ("Watson", the "Company", "we", "us" or "our") is a leading integrated global pharmaceutical company engaged in the development, manufacturing, marketing, sale and distribution of generic and brand pharmaceutical products. We operate in key international markets including Western Europe, Canada, Australasia, Asia, South America and South Africa with our key commercial market being the United States of America ("U.S."). As of December 31, 2010, we marketed approximately 160 generic pharmaceutical product families and approximately 30 brand pharmaceutical product families in the U.S. and a significant number of product families internationally through our Global Generics and Global Brands Divisions, respectively, and distributed approximately 8,500 stock-keeping units ("SKUs") through our Distribution Division.

Our principal executive offices are located at 311 Bonnie Circle, Corona, California 92880. Our Internet website address is www.watson.com. We do not intend this website address to be an active link or to otherwise incorporate by reference the contents of the website into this report. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and all amendments thereto are available free of charge on our Internet website. These reports are posted on our website as soon as reasonably practicable after such reports are electronically filed with the U.S. Securities and Exchange Commission ("SEC"). The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room or electronically through the SEC website (www.sec.gov). Within the Investors section of our website, we provide information concerning corporate governance, including our Corporate Governance Guidelines, Board Committee Charters and Composition, Code of Conduct and other information. See "ITEM 1A. RISK FACTORS-CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS" in this Annual Report on Form 10-K ("Annual Report").

Acquisition of Arrow

On December 2, 2009, Watson completed its acquisition of all the outstanding shares of common stock of Robin Hood Holdings Limited, a Malta private limited liability company, and Cobalt Laboratories, Inc., a Delaware corporation (together the "Arrow Group") for cash, stock and certain contingent consideration (the "Arrow Acquisition"). In accordance with the terms of the share purchase agreement dated June 16, 2009, as amended on November 26, 2009 (together the "Acquisition Agreement"), the Company acquired all the outstanding shares of common stock of the Arrow Group for the following consideration:

- The payment of cash and the assumption of certain liabilities totaling \$1.05 billion;
- Approximately 16.9 million restricted shares of Common Stock of Watson (the "Restricted Common Stock");
- 200,000 shares of newly designated mandatorily redeemable, non-voting Series A Preferred Stock of Watson (the "Mandatorily Redeemable Preferred Stock") placed in an indemnity escrow account for the benefit of the former shareholders of the Arrow Group (the "Arrow Selling Shareholders"). The Arrow Selling Shareholders will be entitled to the proceeds of the Mandatorily Redeemable Preferred Stock in 2012, less the amount of any indemnity payments; and
- Certain contingent consideration based on the after-tax gross profits on sales of the authorized generic version of Lipitor[®] (atorvastatin) in the U.S. calculated and payable as described in the Acquisition Agreement.

Arrow Group operating results are included in the Global Generics segment subsequent to the date of acquisition.

As part of the Arrow Acquisition, Watson acquired a 36% ownership interest in Eden Biopharm Group Limited ("Eden"), a company which provides development and manufacturing services for early-stage biotech

[Table of Contents](#)

companies, which will provide a long-term foundation for the development of generic biologics. In January 2010, we purchased the remaining 64% interest in Eden for \$15.0 million. Eden's results are included in our Global Brands segment. Eden will maintain its established contract services model, while providing the Company with biopharmaceutical development and manufacturing capabilities.

Business Description

Prescription pharmaceutical products in the U.S. generally are 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. Through our Distribution Segment, we distribute pharmaceutical products, primarily generics, which have been commercialized by us and others, to pharmacies and physicians' offices. As a result of the differences between the types of products we market and/or distribute and the methods we distribute products, we operate and manage our business as three operating segments: Global Generics, Global Brands and Distribution. Outside the U.S., our operations are primarily in Western Europe and Canada. In many of these markets, there is limited generic substitution by pharmacists and as a result, products are often promoted to pharmacies. Therefore, physician and pharmacist loyalty to a specific company's generic product can be a significant factor in obtaining market share.

Business Strategy

We apply three key strategies to grow our Global Generics and Global Brands pharmaceutical businesses: (i) internal development of differentiated and high demand products, (ii) establishment of strategic alliances and collaborations and (iii) acquisition of products and companies that complement our current business. We believe our three-pronged strategy will allow us to expand both our brand and generic product offerings. Our Distribution business distributes products for over 200 suppliers and is focused on providing next-day delivery and responsive service to its customers. Our Distribution business also distributes a number of Watson generic and brand products. Growth in our Distribution business will be largely dependent upon FDA approval of new generic products in the U.S.

With the Arrow Acquisition in 2009, we now have commercial operations in a number of established international markets with the opportunity for rapid growth in many emerging markets around the world. We believe a global presence will allow us to expand our revenue base and manage risk through diversification. We expect to capitalize on opportunities for growth within these new markets. Additionally, we will continue to look for opportunities to enhance these capabilities through further strategic collaborations or acquisitions.

Based upon business conditions, our financial strength and other factors, we regularly reexamine our business strategies and may change them at anytime. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business" in this Annual Report.

Global Generics Segment

Watson is a leader in the development, manufacturing and sale of generic pharmaceutical products. When patents or other regulatory exclusivity no longer protect a brand product, opportunities exist to introduce generic counterparts to the brand product. These generic products are bioequivalent to their brand name counterparts and are generally sold at significantly lower prices than the brand product. As such, generic pharmaceuticals provide an effective and cost-efficient alternative to brand products. Our portfolio of generic products includes products we have developed internally, products we have licensed from third parties and products we distribute for third parties. Net revenues in our Global Generics segment accounted for \$2.3 billion or approximately 66% of our total net revenues in 2010. At December 31, 2010, our global generics business in the U.S. remains the dominant source of revenue for the Company with approximately 80% of total generic net revenues coming from our U.S. businesses.

[Table of Contents](#)

Global Generics Strategy

Our Global Generics business is focused on maintaining a leading position within the U.S. generics market and strengthening our global position by offering a consistent and reliable supply of quality generic products. We are leveraging our broad product line by expanding commercial operations outside of the U.S.

Our strategy in the U.S. is to develop generic pharmaceuticals that are difficult to formulate or manufacture or will complement or broaden our existing product lines. Internationally, our strategy is to grow our market share in key markets while expanding our presence in new markets. We plan to accomplish this through new product launches, filing existing products overseas and in-licensing products through strategic alliances. Since the sales and unit volumes of our brand products will likely decrease upon the introduction of generic alternatives, we also intend to market generic alternatives to our brand products where market conditions and the competitive environment justify such activities. 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.

We have maintained an ongoing effort to enhance efficiencies and reduce costs in our manufacturing operations. Execution of these initiatives will allow us to maintain competitive pricing on our products.

Global Generics Business Development

In conjunction with our strategy to grow and expand internationally and diversify our business, on October 4, 2010, we announced a partnership with Moksha8 Pharmaceuticals Inc. ("Moksha8") for Moksha8 to market a select number of our products in Latin America, specifically in the two largest Latin American markets of Brazil and Mexico. Watson agreed to make an initial \$30.0 million investment in exchange for a significant minority ownership position in Moksha8. We have also committed to invest an additional \$20.0 million, further increasing our equity position, contingent upon successful execution by Moksha8 of additional third-party product acquisitions. In conjunction with our investment in Moksha8, we have also designated a representative to serve as a member of the Moksha8 board of directors. Watson will manufacture and supply select products to Moksha8, which will have exclusive rights to market, sell and distribute these products in Brazil and Mexico. Moksha8 and Watson have initially identified approximately one dozen product candidates, with the opportunity to expand the commercialization and marketing agreement to include additional products in the future. The products are expected to be launched beginning in the first half of 2011.

In 2010, Watson entered into an exclusive agreement with Ortho-McNeil-Janssen Pharmaceuticals, Inc. ("OMJPI"), to market the Authorized Generic version of Concerta[®] (methylphenidate hydrochloride). Under the terms of the agreement, OMJPI will supply Watson with the product. Watson will launch its Authorized Generic of Concerta[®] on May 1, 2011, or earlier under certain circumstances.

[Table of Contents](#)

Global Generics Product Portfolio

Our portfolio of approximately 160 generic pharmaceutical product families in the U.S. includes the following key products which represented approximately 57% of total Global Generics segment product revenues in 2010:

Watson Generic Product	Comparable Brand Name	Therapeutic Classification
Azurette™	Mircette®	Oral contraceptive
Bupropion hydrochloride SR	Zyban®	Aid to smoking cessation
Bupropion hydrochloride SR	Wellbutrin SR®	Anti-depressant
Bupropion hydrochloride XL	Wellbutrin XL®	Anti-depressant
Desmopressin acetate	DDAVP®	Antidiuretic
Diclofenac sodium	Arthrotec®	Osteoarthritis and rheumatoid arthritis
Diltizem HCl ER	Cardizem® LA	Calcium channel blocker
Dronabinol	Marinol®	Antiemetic
Fentanyl transdermal system	Duragesic®	Analgesic/narcotic combination
Glipizide ER	Glucotrol® XL	Anti-diabetic
Hydrocodone bitartrate/ acetaminophen	Lorcet®, Vicodin®, Lortab®, Norco®/Anexia	Analgesic
Levora®	Nordette®	Oral contraceptive
Low-Ogestrel®	Lo-Ovral®	Oral contraceptive
Lutera®	Alesse®	Oral contraceptive
Metoprolol succinate	Toprol XL®	Anti-hypertensive
Microgestin®/Microgestin® Fe	Loestrin®/Loestrin® Fe	Oral contraceptive
Necon®	Ortho-Novum®, Modicon®	Oral contraceptive
Next Choice™	Plan B®	Emergency oral contraceptive
Nicotine polacrilex gum	Nicorette®	Aid to smoking cessation
Oxycodone/acetaminophen	Percocet®	Analgesic
Potassium chloride ER	Micro-K®	Hypokalemia
Potassium XR	Augmentin XR®	Hypokalemia
Quasense	Seasonale®	Oral contraceptive
Reclipsen®	Ortho-Cept®	Oral contraceptive
Taztia XT®	Tiazac®	Anti-hypertensive
TriNessa™	Ortho Tri-Cyclen®	Oral contraceptive
Trivora®	Triphasil®	Oral contraceptive
Zarah™	Yasmin®	Oral contraceptive
Zovia®	Demulen®	Oral contraceptive

In the U.S., we predominantly market our generic products to various drug wholesalers, mail order, government and national retail drug and food store chains utilizing 21 sales and marketing professionals. We sell our generic prescription products primarily under the "Watson Laboratories" and "Watson Pharma" labels, with the exception of our over-the-counter generic products which we sell under our Rugby® label or under private label.

During 2010, we expanded our generic product line with the launch of seven generic products. Key U.S. generic launches in 2010 included diltiazem ER 180 mg and 240 mg, metoprolol succinate ER 100 mg and 200 mg, valacyclovir, tacrolimus 5 mg, Zarah™ (a generic version of Yasmin®), rivastigmine and amlodipine besylate/benazepril.

Watson currently has a leading U.S. market position in generic oral contraceptives with over 30 product formulations and a 36% market share. Our top five oral contraceptives, NextChoice™, Microgestin®, TriNessa®, Necon® and Lutera®, account for almost 50% of the total Watson oral contraceptives portfolio. Key

[Table of Contents](#)

oral contraceptive products in the pipeline include generic versions of Yaz[®], Seasonique[®], LoSeasonique[®] and Tri-Cyclen Lo[®].

Operations in Key International Markets

Outside the U.S., our operations are primarily in Western Europe and Canada. In many of these markets, there is limited generic substitution by pharmacists and as a result, products are often promoted to pharmacies. Therefore, physician and pharmacist loyalty to a specific company's generic product can be a significant factor in obtaining market share.

In 2010, certain governments in Europe and Canada implemented various healthcare reforms in an attempt to manage health care budget expenditures. As a result of difficult economic conditions in many of these regions, these healthcare reforms had a greater than expected impact on our industry when compared with previous years, as many governments mandated lower generic pricing as a method of cost savings for their annual health care expenditures. We expect pricing pressures to continue in many of our key markets. However, the impact of government healthcare reform in 2011 is expected to be less than in 2010.

Canada

Canada's generics market, with an estimated value of approximately \$5.6 billion, is one of the largest generic markets in the world. Generic pharmaceuticals are substituted at the pharmacy. The provincial governments have direct control over pricing and reimbursement in Canada.

Watson's Global Generics division operates in Canada as Cobalt Pharmaceuticals. We actively market 54 products in Canada and have 40 sales representatives promoting our products to pharmacies.

U.K.

The U.K. generics market has an estimated value of approximately \$3.6 billion and is one of the world's largest in terms of both size and generic penetration. The U.K. government has direct control over pricing and reimbursement.

We now do business in the U.K. as Arrow Generics and currently market 100 different products. We also have alliances to assist in the distribution of these products.

France

France has an estimated generics market value of approximately \$3.5 billion. The French government regulates and promotes generics and incentivizes pharmacists to dispense them. There are approximately 23,000 pharmacies in France. It is a strong branded generic market where substitution at the pharmacy level is limited.

We now do business in France as Arrow Generiques and market 138 different molecules. We have over 65 sales representatives calling on the individual pharmacies. The generic market is expected to grow with doctors incentivized to prescribe generics. There are also a number of brand products losing exclusivity in 2011, which should create future opportunities for growth in this market.

Global Generics Research and Development

We devote significant resources to the research and development ("R&D") of generic products and proprietary drug delivery technologies. Watson incurred Global Generics segment R&D expenses of approximately \$195.0 million in 2010, \$140.0 million in 2009 and \$119.0 million in 2008. We are presently developing a number of generic products through a combination of internal and collaborative programs.

[Table of Contents](#)

Our Global Generics R&D strategy focuses on the following product development areas:

- off-patent drugs that are difficult to develop or manufacture, or that complement or broaden our existing product lines;
- the development of sustained-release and other drug delivery technologies and the application of these technologies to proprietary drug forms; and
- using in-house technologies to develop new products.

As of December 31, 2010, we conducted R&D in Corona, California; Copiague, New York; Davie and Weston, Florida; Salt Lake City, Utah; Ambernath and Mumbai, India; Mississauga, Canada; and Melbourne, Australia. In 2010, we announced plans to close R&D facilities in Melbourne, Australia and Mississauga, Canada. The transfer of development activities from our Melbourne, Australia facility to other existing research and development sites will be completed in the first quarter of 2011. In January 2011, we announced plans to close R&D facilities in Corona, California by the end of 2011.

In 2010, our product development efforts resulted in the submission of over 30 Abbreviated New Drug Applications ("ANDAs") in the U.S. and more than 145 applications globally. At December 31, 2010, we had more than 120 ANDAs on file in the U.S. and a significant number of applications on file internationally. See the "Government Regulation and Regulatory Matters" section below for a description of our process for obtaining U.S. Food and Drug Administration ("FDA") approval for our products. See also "ITEM 1A. RISK FACTORS — Risks Related to our Business — Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development, manufacturing and distribution capabilities." in this Annual Report.

Global Brands Segment

Newly developed pharmaceutical products normally are patented and, as a result, are generally offered by a single provider when first introduced to the market. We currently market a number of branded products to physicians, hospitals, and other markets that we serve. We classify these patented and off-patent trademarked products as our brand pharmaceutical products. During 2010, we launched Crinone[®], ella[®], and Trelstar[®] 22.5 mg. Crinone[®] was acquired from Columbia Laboratories, Inc. ("Columbia") and is currently used for progesterone supplementation or replacement as part of an Assisted Reproductive Technology treatment for infertile women with a progesterone deficiency. Ella[®] is an emergency contraceptive proven effective in helping prevent pregnancies for up to five days after unprotected intercourse or contraceptive failure. Trelstar[®] 22.5 mg is a 6-month intramuscular GnRH agonist for the palliative treatment of advanced prostate cancer. Net revenues in our Global Brands segment accounted for approximately \$398.0 million or approximately 11% of our total net revenues in 2010. Typically, our brand products realize higher profit margins than our generic products.

Our portfolio of over 30 brand pharmaceutical product families includes the following products, which represented approximately 70% of total Global Brands segment product revenues in 2010:

Watson Brand Product	Active Ingredient	Therapeutic Classification
Androderm [®]	Testosterone (transdermal patch)	Male testosterone replacement
Gelnique [®]	Oxybutnin chloride (gel 10)%	Overactive bladder
INFeD [®]	Iron dextran	Hematinic
Oxytrol [®]	Oxybutnin (transdermal patch)	Overactive bladder
Rapaflo [®]	Silodosin	Benign prostatic hyperplasia
Trelstar [®]	Triptorelin pamoate injection	Prostate cancer

We market our brand products through approximately 350 sales professionals. Our sales and marketing efforts focus on physicians, specifically urologists, obstetricians and gynecologists, who specialize in the diagnosis and treatment of particular medical conditions and each group offers products to satisfy the unique needs of these physicians. Approximately 60 of these sales professionals are strategic account specialists who

[Table of Contents](#)

focus on institutions and clinics. We believe this focused sales and marketing approach enables us to foster close professional relationships with specialty physicians, as well as cover the primary care physicians who also prescribe in selected therapeutic areas. We generally sell our brand products under the "Watson Pharma" label. We believe that the current structure of sales professionals is very adaptable to the additional products we plan to add to our brand portfolio, particularly in the therapeutic category of women's health.

We actively promote Rapaflo[®], Gelnique[®], Trelstar[®], Crinone[®], ella[®] and INFeD[®]. Our Global Brands segment also receives other revenues consisting of co-promotion revenue and royalties. We promote AndroGel[®] on behalf of Abbott Laboratories ("Abbott") and Femring[®] on behalf of Warner Chilcott Ltd. We expect to continue this strategy of supplementing our existing brand revenues with co-promoted products within our targeted therapeutic areas. Other revenue totaled \$81.5 million for 2010 or approximately 20% of our total Global Brands segment net revenue.

Global Brands Research and Development

We devote significant resources to the R&D of brand products and proprietary drug delivery technologies. A number of our brand products are protected by patents and have enjoyed market exclusivity. We incurred Global Brands segment R&D expenses of approximately \$102.0 million in 2010, \$57.0 million in 2009 and \$51.0 million in 2008.

Our Global Brands R&D strategy focuses on the following product development areas:

- the application of proprietary drug-delivery technology for new product development in specialty areas; and
- the acquisition of mid-to-late development-stage brand drugs.

We are presently developing a number of brand products, some of which utilize novel drug-delivery systems, through a combination of internal and collaborative programs. We also acquired Eden, a company involved in biologics research and development.

Products in the brand pipeline include Prochieve[®] 8% for the prevention of pre-term birth in women with a short cervix, as well as two novel long-acting contraceptives in late stage development, a progestin-only patch and a vaginal ring. We received approval in December 2010 for a novel chewable oral contraceptive licensed from Warner Chilcott Ltd., which we expect to launch in the second quarter of 2011. We also have a number of products in development as part of our life-cycle management strategy on our existing product portfolio.

Biopharmaceuticals or Biologics

Biopharmaceuticals will represent a significant opportunity in the future, and we have taken strategic steps to enhance our ability to offer products in this area. We believe biologics will require selling and marketing resources for promotion. Therefore, our biologics development efforts are managed by our Global Brands division.

In January 2010, we acquired the remaining 64% of Eden for approximately \$15.0 million, making Eden a wholly-owned subsidiary. Eden is a biopharmaceutical development and contract manufacturing company located in Liverpool, UK. Eden will maintain its established contract services model, while providing the Company with proven biopharmaceutical development and manufacturing capabilities.

In July 2010, we announced an exclusive, worldwide licensing agreement with Itero Biopharmaceuticals, Inc. ("Itero"), a venture-backed specialty biopharmaceutical company, to develop and commercialize Itero's recombinant follicle stimulating hormone ("rFSH") product. The product is currently in preclinical development as a biosimilar molecule for the treatment of female infertility. Under the terms of the agreement, Watson paid Itero an undisclosed licensing fee and will make additional payments based on the achievement of certain development and regulatory performance milestones. Upon successful commercialization, Watson will also pay

[Table of Contents](#)

Itero a percentage of net sales or net profits in various regions of the world. Watson will assume responsibility for all future development, manufacturing, and commercial expenses related to Itero's rFSH product.

The licensing of rFSH is an example of how we plan to enter biologics, with products that are past the pre-clinical development phase and complement our existing business.

Global Brands Business Development

In 2010 we entered into a number of agreements as part of our efforts to expand our brand product portfolio, specifically in Women's Health.

In February 2010, we announced an exclusive licensing agreement for Watson to become the U.S. commercial partner for ella[®] (ulipristal acetate), a selective progesterone receptor modulator. ella[®] is a novel next-generation emergency contraceptive developed by HRA Pharma specifically for emergency contraceptive use. Under the terms of the agreement, Watson will be responsible for all U.S. commercialization and marketing expenses and pay HRA Pharma a royalty on U.S. sales of the product. ella[®] was approved by the FDA in August 2010 and launched in the U.S. in December 2010. In September 2010, we expanded our agreement with HRA Pharma to become the commercial partner for ella[®] in Canada.

In March 2010 we announced the acquisition of the exclusive U.S. rights to Columbia's bioadhesive progesterone gel business. Products included in the acquisition were Crinone[®] for the treatment of infertility and Prochieve[®] under development for the prevention of pre-term birth in women with a short cervix. Under the terms of the agreement, we paid Columbia \$62.0 million in cash and agreed to make certain contingent payments in return for exclusive progesterone gel product rights in the U.S. and 11.2 million newly issued shares of Columbia common stock. We also obtained the right to designate a member of Columbia's board of directors. Contingent payments will be made upon the successful completion of clinical development milestones, receipt of regulatory approvals and product launches and could total up to \$45.5 million. In addition, we will pay a royalty on our sales of the progesterone gel product line and any subsequent products. Pursuant to a supply agreement, Columbia will be responsible for manufacturing the progesterone gel products. Following the initial announcement in March 2010, we entered into an agreement with Columbia to support Columbia's ongoing investment in the clinical development of the pre-term birth indication for Prochieve[®], as well as other Columbia capital requirements.

Following the close of the acquisition, Watson and Columbia jointly announced top-line results from the PREGNANT Study, a large, global Phase III clinical trial evaluating Prochieve[®] 8% vaginal progesterone gel to reduce the risk of preterm birth in women with a short cervical length as measured by transvaginal ultrasound at mid-pregnancy. Columbia expects to file a new drug application ("NDA") in the first half of 2011. We plan to collaborate with Columbia in the global development of a second-generation vaginal progesterone product.

In March 2010, we announced an exclusive licensing agreement to commercialize the Population Council's investigational contraceptive vaginal ring in the United States, Canada, and Mexico. The ring, which contains two hormonal products — ethinyl estradiol and Nestorone[®], a novel, synthetic progestin, has concluded its Phase 3 clinical development and is currently undergoing safety studies customary with the introduction of a novel hormonal product.

In December 2010, we announced an exclusive licensing agreement with PregLem, S.A., ("PregLem") now a wholly-owned subsidiary of Gedeon Richter Plc, to develop and market Esmya[™] (ulipristal acetate), a product for the treatment of uterine fibroids, in the U.S. and Canada. The product MMA has recently been submitted for approval in Europe and Watson expects to initiate U.S. Phase III clinical studies in 2011. Under terms of the agreement, Watson paid PregLem a \$17.0 million license fee and will pay royalties based on sales in the U.S. and Canada. Watson will make additional payments based on the achievement of certain regulatory milestones. The companies will also collaborate on additional Esmya[™] formulations, jointly sharing the development costs.

[Table of Contents](#)

Additionally, we intend to market various products within our Global Brands segment globally. As part of this strategy, we have filed for regulatory approval of a number of our brand products with various regulatory agencies internationally including Rapaflo[®], Gelnique[®] and ella[®] in Canada and Gelnique[®] in Europe.

Distribution Segment

Our Distribution business, which consists of our Anda, Anda Pharmaceuticals and Valmed (also known as "VIP") subsidiaries (collectively "Anda"), primarily distributes generic and selected brand pharmaceutical products to independent pharmacies, alternate care providers (hospitals, nursing homes and mail order pharmacies), pharmacy chains and physicians' offices. Additionally, we sell to members of buying groups, which are independent pharmacies that join together to enhance their buying power. We believe that we are able to effectively compete in the distribution market, and therefore optimize our market share, based on three critical elements: (i) competitive pricing, (ii) high levels of inventory for approximately 8,500 SKUs for responsive customer service that includes, among other things, next day delivery to the entire U.S., and (iii) well established telemarketing relationships with our customers, supplemented by our electronic ordering capabilities. While we purchase most of the approximate 8,500 SKUs in our Distribution operations from third party manufacturers, we also utilize these operations for the sale and marketing of our own products and our collaborative partners' products. We are the only U.S. pharmaceutical company that has meaningful distribution operations with direct access to independent pharmacies and we believe that our Distribution operation is a strategic asset in the national distribution of generic and brand pharmaceuticals.

Revenue growth in our distribution operations will primarily be dependent on the launch of new products, offset by the overall level of net price and unit declines on existing distributed products and will be subject to changes in market share.

We presently distribute products from our facilities in Weston, Florida and Groveport, Ohio. For the year ended December 31, 2010, approximately 67% of our Distribution sales were shipped from our Groveport, Ohio facility and 33% from our Weston, Florida facility, though this percentage can vary. While our Weston, Florida facility is operating at 70% capacity, our 355,000 square foot Ohio distribution center currently operates at approximately 35% capacity, and provides us with additional distribution capacity for the U.S. market.

Strategic Alliances and Collaborations

In 2004, we entered into an exclusive licensing agreement with Kissei Pharmaceutical Co., Ltd. ("Kissei") to develop and market Rapaflo[®] for the North American market. The compound was originally developed and launched by Kissei in Japan as Urief[®] and is marketed in Japan in cooperation with Daiichi Sankyo Pharmaceutical Co., Ltd. for the treatment of the signs and symptoms of benign prostatic hyperplasia.

In 2006, we entered into an agreement with Solvay Pharmaceuticals, Inc. ("Solvay") to utilize Watson's Brands sales force to co-promote AndroGel[®] to urologists in the U.S. In February of 2010, Solvay was acquired by Abbott.

We have an exclusive agreement with Pfizer, Inc. to market the Authorized Generic version of Lipitor[®] (atorvastatin calcium). Under the terms of the agreement, Pfizer, Inc. will supply Watson with the product for distribution beginning in November 2011 or earlier under certain circumstances.

Financial Information About Segments

Watson evaluates the performance of its Global Generics, Global Brands and Distribution business segments based on net revenues and net contribution. Summarized net revenues and contribution information for each of the last three fiscal years in the U.S. and internationally, where applicable, is presented in "NOTE 13 — Reportable Segments" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

[Table of Contents](#)

Customers

In our Global Generics and Global Brands operations, we sell our generic and brand pharmaceutical products primarily to drug wholesalers, retailers and distributors, including national retail drug and food store chains, hospitals, clinics, mail order, government agencies and managed healthcare providers such as health maintenance organizations and other institutions. In our Distribution business, we distribute generic and certain select brand pharmaceutical products to independent pharmacies, members of buying groups, alternate care providers (hospitals, nursing homes and mail order pharmacies), pharmacy chains and physicians' offices.

Sales to certain of our customers accounted for 10% or more of our annual net revenues during the past three years. The following table illustrates any customer, on a global basis, which accounted for 10% or more of our annual net revenues and the respective percentage of our net revenues for which they account for each of the last three years:

Customer	2010	2009	2008
Walgreen Co.	14%	13%	11%
McKesson Corporation	11%	11%	11%

McKesson and certain of our other customers comprise a significant part of the distribution network for pharmaceutical products in the U.S. As a result, a small number of large, wholesale distributors and large chain drug stores control a significant share of the market. This concentration may adversely impact pricing and create other competitive pressures on drug manufacturers. Our Distribution business competes directly with our large wholesaler customers with respect to the distribution of generic products.

The loss of any of these customers could have a material adverse effect on our business, results of operations, financial condition and cash flows. See "ITEM 1A. RISK FACTORS — Risk Relating to Investing in the Pharmaceutical Industry" in this Annual Report.

Competition

The pharmaceutical industry is highly competitive. In our Global Generics and Global Brands businesses, we compete with different companies depending upon product categories, and within each product category, upon dosage strengths and drug delivery systems. Such competitors include the major brand name and generic manufacturers of pharmaceutical products. In addition to product development, other competitive factors in the pharmaceutical industry include product quality and price, reputation and service and access to proprietary and technical information. It is possible that developments by others will make our products or technologies noncompetitive or obsolete.

Competing in the brand product business requires us to identify and bring to market new products embodying technological innovations. Successful marketing of brand products depends primarily on the ability to communicate their effectiveness, safety and value to healthcare professionals in private practice, group practices and receive formulary status from managed care organizations. We anticipate that our brand product offerings will support our existing areas of therapeutic focus. Based upon business conditions and other factors, we regularly reevaluate our business strategies and may from time to time reallocate our resources from one therapeutic area to another, withdraw from a therapeutic area or add an additional therapeutic area in order to maximize our overall growth opportunities. Our competitors in brand products include major brand name manufacturers of pharmaceuticals. Based on total assets, annual revenues and market capitalization, our Global Brands segment is considerably smaller than many of these competitors and other global competitors in the brand product area. Many of our competitors have been in business for a longer period of time, have a greater number of products on the market and have greater financial and other resources than we do. If we directly compete with them for certain contracted business, such as the Pharmacy Benefit Manager business, and for the same markets and/or products, their financial strength could prevent us from capturing a meaningful share of those markets.

We actively compete in the generic pharmaceutical industry. Revenues and gross profit derived from the sales of generic pharmaceutical products tend to follow a pattern based on certain regulatory and competitive factors. As patents and regulatory exclusivity for brand name products expire or are successfully challenged,

[Table of Contents](#)

the first off-patent manufacturer to receive regulatory approval for generic equivalents of such products is generally able to achieve significant market penetration. As competing off-patent manufacturers receive regulatory approvals on similar products, market share, revenues and gross profit typically decline, in some cases dramatically. Accordingly, the level of market share, revenues and gross profit attributable to a particular generic product normally is related to the number of competitors in that product's market and the timing of that product's regulatory approval and launch, in relation to competing approvals and launches. Consequently, we must continue to develop and introduce new products in a timely and cost-effective manner to maintain our revenues and gross profit. In addition to competition from other generic drug manufacturers, we face competition from brand name companies in the generic market. Many of these companies seek to participate in sales of generic products by, among other things, collaborating with other generic pharmaceutical companies or by marketing their own generic equivalent to their brand products as Authorized Generics. Our major competitors in generic products include Teva Pharmaceutical Industries, Ltd., Mylan Inc. and Sandoz (a division of Novartis AG). See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — The pharmaceutical industry is highly competitive and our future revenue growth and profitability are dependent on our timely development and launches of new products ahead of our competitors." in this Annual Report.

In our Distribution business, we compete with a number of large wholesalers and other distributors of pharmaceuticals, including McKesson Corporation, AmerisourceBergen Corporation and Cardinal Health, Inc., which distribute both brand and generic pharmaceutical products to their customers. These same companies are significant customers of our Global Generics and Global Brands pharmaceutical businesses. As generic products generally have higher gross margins than brand products for a pharmaceutical distribution business, each of the large wholesalers, on an increasing basis, are offering pricing incentives on brand products if the customers purchase a majority of their generic pharmaceutical products from the primary wholesaler. As we do not offer a broad portfolio of brand products to our customers, we are at times competitively disadvantaged and must compete with these wholesalers based upon our very competitive pricing for generic products, greater service levels and our well-established telemarketing relationships with our customers, supplemented by our electronic ordering capabilities. Additionally, generic manufacturers are increasingly marketing their products directly to drug store chains with warehousing facilities and thus increasingly bypassing wholesalers and distributors. Increased competition in the generic industry as a whole may result in increased price erosion in the pursuit of market share.

Manufacturing, Suppliers and Materials

During 2010, we manufactured many of our own finished products at our plants in Corona, California; Davie, Florida; Goa, India; Birzebbugia, Malta; Mississauga, Canada; Rio de Janeiro, Brazil; Carmel, New York; Copiague, New York and Salt Lake City, Utah. As part of an ongoing effort to optimize our manufacturing operations, we have implemented several cost reduction initiatives, which included the transfer of several solid dosage products from our Carmel, New York facility to our Goa, India facility, and the ongoing implementation of our Global Supply Chain Initiative at certain of our manufacturing facilities.

We have development and manufacturing capabilities for raw material and active pharmaceutical ingredients ("API") and intermediate ingredients to support our internal product development efforts in our Coleraine, Northern Ireland and Ambernath, India facilities. Our Ambernath, India facility also develops and manufactures API for third parties.

Our manufacturing operations are subject to extensive regulatory oversight and could be interrupted at any time. Our Corona, California facility is currently subject to a consent decree of permanent injunction. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development, manufacturing and distribution capabilities." Also refer to *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

We contract with third parties for the manufacture of certain of our products, some of which are currently available only from sole or limited suppliers. These third-party manufactured products include products that have historically accounted for a significant portion of our revenues, such as bupropion hydrochloride

Table of Contents

sustained-release tablets and a number of our oral contraceptive products. Third-party manufactured product sales by our Global Generics and Global Brands segments, accounted for approximately 33%, 38% and 44% of our product net revenues in 2010, 2009 and 2008, respectively.

We are dependent on third parties for the supply of the raw materials necessary to develop and manufacture our products, including the API and inactive pharmaceutical ingredients used in our products. We are required to identify the supplier(s) of all the raw materials for our products in the drug applications that we file with the FDA. If raw materials for a particular product become unavailable from an approved supplier specified in a drug application, we would be required to qualify a substitute supplier with the FDA, which would likely interrupt manufacturing of the affected product. To the extent practicable, we attempt to identify more than one supplier in each drug application. However, some raw materials are available only from a single source and, in many of our drug applications, only one supplier of raw materials has been identified, even in instances where multiple sources exist.

In addition, we obtain a significant portion of our raw materials from foreign suppliers. Arrangements with international raw material suppliers are subject to, among other things, FDA regulation, customs clearance, various import duties, foreign currency risk and other government clearances. Acts of governments outside the U.S. may affect the price or availability of raw materials needed for the development or manufacture of our products. In addition, any changes in patent laws in jurisdictions outside the U.S. may make it increasingly difficult to obtain raw materials for R&D prior to the expiration of the applicable U.S. or foreign patents. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — If we are unable to obtain sufficient supplies from key suppliers that in some cases may be the only source of finished products or raw materials, our ability to deliver our products to the market may be impeded." in this Annual Report.

We continue to make substantial progress on our Global Supply Chain Initiative and the transfer of product manufacturing from our New York facility to our Florida, California, and Goa, India sites. At the end of 2010, approximately 20% of our internally sourced manufactured product was produced from our Goa, India facility. At the end of 2010, we closed our Carmel, New York solid dosage manufacturing facility. Additionally, during the year we announced plans to close our manufacturing facility and R&D facilities in Mississauga, Canada by late 2011 with product being transferred to facilities with additional capacity in the Watson global network, including Malta and India and the transfer of development activities to other existing R&D sites. In January 2011, the Company announced the closure of R&D activities in Corona, California and the transfer of development activities to existing R&D sites. We will continue to implement operational efficiency programs at our remaining sites.

Patents and Proprietary Rights

We believe patent protection of our proprietary products is important to our Global Brands business. Our success with our brand products will depend, in part, on our ability to obtain, and successfully defend if challenged, patent or other proprietary protection for such products. We currently have a number of U.S. and foreign patents issued or pending. However, the issuance of a patent is not conclusive as to its validity or as to the enforceable scope of the claims of the patent. Accordingly, our patents may not prevent other companies from developing similar or functionally equivalent products or from successfully challenging the validity of our patents. If our patent applications are not approved or, even if approved, if such patents are circumvented or not upheld in a court of law, our ability to competitively market our patented products and technologies may be significantly reduced. Also, such patents may or may not provide competitive advantages for their respective products or they may be challenged or circumvented by competitors, in which case our ability to commercially market these products may be diminished. From time to time, we may need to obtain licenses to patents and other proprietary rights held by third parties to develop, manufacture and market our products. If we are unable to timely obtain these licenses on commercially reasonable terms, our ability to commercially market such products may be inhibited or prevented. Patents covering our Androderm® and INFed® products have expired and we have no further patent protection on these products. Therefore, it is possible that a competitor may launch a generic version of Androderm® and/or INFed® at any time, which would result in a significant decline in that product's revenue and profit. Both of these products were significant contributors to our Global Brands business in 2010.

[Table of Contents](#)

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

We may find it necessary to initiate litigation to enforce our patent rights, to protect our trade secrets or know-how or to determine the scope and validity of the proprietary rights of others. Litigation concerning patents, trademarks, copyrights and proprietary technologies can often be protracted and expensive and, as with litigation generally, the outcome is inherently uncertain.

Pharmaceutical companies with brand products are suing companies that produce off-patent forms of their brand name products for alleged patent infringement or other violations of intellectual property rights which may delay or prevent the entry of such a generic product into the market. For instance, when we file an ANDA in the U.S. seeking approval of a generic equivalent to a brand drug, we may certify under the Drug Price Competition and Patent Restoration Act of 1984 (the "Hatch-Waxman Act") to the FDA that we do not intend to market our generic drug until any patent listed by the FDA as covering the brand drug has expired, in which case, the ANDA will be approved by the FDA no earlier than the expiration or final finding of invalidity of such patent(s). On the other hand, we could certify that we believe the patent or patents listed as covering the brand drug are invalid and/or will not be infringed by the manufacture, sale or use of our generic form of the brand drug. In that case, we are required to notify the brand product holder or the patent holder that such patent is invalid or is not infringed. If the patent holder sues us for patent infringement within 45 days from receipt of the notice, the FDA is then prevented from approving our ANDA for 30 months after receipt of the notice unless the lawsuit is resolved in our favor in less time or a shorter period is deemed appropriate by a court. In addition, increasingly aggressive tactics employed by brand companies to delay generic competition, including the use of Citizen Petitions and seeking changes to U.S. Pharmacopeia, have increased the risks and uncertainties regarding the timing of approval of generic products.

Litigation alleging infringement of patents, copyrights or other intellectual property rights may be costly and time consuming. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — Third parties may claim that we infringe their proprietary rights and may prevent us from manufacturing and selling some of our products." in this Annual Report.

Because a balanced and fair legislative and regulatory arena is critical to the pharmaceutical industry, we will continue to devote management time and financial resources on government activities. We currently maintain an office and staff a full-time government affairs function in Washington, D.C. that maintains responsibility for keeping abreast of state and federal legislative activities.

Government Regulation and Regulatory Matters

All pharmaceutical manufacturers, including Watson, are subject to extensive, complex and evolving regulation by the federal government, principally the FDA, and to a lesser extent, by the U.S. Drug Enforcement Administration ("DEA"), Occupational Safety and Health Administration and state government agencies, as well as by various regulatory agencies in foreign countries where our products or product candidates are being manufactured and/or marketed. The Federal Food, Drug and Cosmetic Act, the Controlled Substances Act and other federal statutes and regulations govern or influence the testing, manufacturing, packing, labeling, storing, record keeping, safety, approval, advertising, promotion, sale and distribution of our products. In our international markets, the approval, manufacture and sale of pharmaceutical products is similar to the United States with some variations dependent upon local market dynamics.

FDA approval is required before any dosage form of any new drug, including an off-patent equivalent of a previously approved drug, can be marketed. The process for obtaining governmental approval to manufacture and market pharmaceutical products is rigorous, time-consuming and costly, and the extent to which it may be affected by legislative and regulatory developments cannot be predicted. We are dependent on receiving FDA and other governmental approvals prior to manufacturing, marketing and shipping new products. Consequently, there is always the risk the FDA or another applicable agency will not approve our new products, or the rate,

[Table of Contents](#)

timing and cost of obtaining such approvals will adversely affect our product introduction plans or results of operations. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — If we are unable to successfully develop or commercialize new products, our operating results will suffer." and "— Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development, manufacturing and distribution capabilities." in this Annual Report.

All applications for FDA approval must contain information relating to product formulation, raw material suppliers, stability, manufacturing processes, packaging, labeling and quality control. There are generally two types of applications for FDA approval that would be applicable to our new products:

- *NDA*. We file a NDA when we seek approval for drugs with active ingredients and/or with dosage strengths, dosage forms, delivery systems or pharmacokinetic profiles that have not been previously approved by the FDA. Generally, NDAs are filed for newly developed brand products or for a new dosage form of previously approved drugs.
- *ANDA*. We file an ANDA when we seek approval for off-patent, or generic equivalents of a previously approved drug.

The process required by the FDA before a previously unapproved pharmaceutical product may be marketed in the U.S. generally involves the following:

- preclinical laboratory and animal tests;
- submission of an investigational new drug application ("IND"), which must become effective before clinical trials may begin;
- adequate and well-controlled human clinical trials to establish the safety and efficacy of the proposed product for its intended use;
- submission of a NDA containing the results of the preclinical and clinical trials establishing the safety and efficacy of the proposed product for its intended use; and
- FDA approval of a NDA.

Preclinical tests include laboratory evaluation of the product, its chemistry, formulation and stability, as well as animal studies to assess the potential safety and efficacy of the product. For products that require NDA approvals, these preclinical studies and plans for initial human testing are submitted to the FDA as part of an IND, which must become effective before we may begin human clinical trials. The IND automatically becomes effective 30 days after receipt by the FDA unless the FDA, during that 30-day period, raises concerns or questions about the conduct of the trials as outlined in the IND. In such cases, the IND sponsor and the FDA must resolve any outstanding concerns before clinical trials can begin. In addition, an independent Institutional Review Board must provide oversight to review and approve any clinical study at the medical center proposing to conduct the clinical trials.

Human clinical trials are typically conducted in the following sequential phases:

- *Phase I*. During this phase, the drug is initially introduced into a relatively small number of healthy human subjects or patients and is tested for safety, dosage tolerance, absorption, metabolism, distribution and excretion.
- *Phase II*. This phase involves studies in a limited patient population to identify possible adverse effects and safety risks, to determine the efficacy of the product for specific targeted diseases or conditions, and to determine dosage tolerance and optimal dosage.
- *Phase III*. When Phase II evaluations demonstrate that a dosage range of the product is effective and has an acceptable safety profile, Phase III trials are undertaken to further evaluate dosage, clinical efficacy and to further test for safety in an expanded patient population at geographically dispersed clinical study sites.

[Table of Contents](#)

- *Phase IV.* After a drug has been approved by the FDA, Phase IV studies may be conducted to explore additional patient populations, compare the drug to a competitor, or to further study the risks, benefits and optimal use of a drug. These studies may be a requirement as a condition of the initial approval.

The results of product development, preclinical studies and clinical studies are submitted to the FDA as part of a NDA, for approval of the marketing and commercial shipment of the new product. The NDA drug development and approval process currently averages approximately five to ten years.

FDA approval of an ANDA is required before we may begin marketing an off-patent or generic equivalent of a drug that has been approved under an NDA, or a previously unapproved dosage form of a drug that has been approved under an NDA. The ANDA approval process generally differs from the NDA approval process in that it does not typically require new preclinical and clinical studies; instead, it relies on the clinical studies establishing safety and efficacy conducted for the previously approved NDA drug. The ANDA process, however, typically requires data to show that the ANDA drug is bioequivalent (i.e., therapeutically equivalent) to the previously approved drug. "Bioequivalence" compares the bioavailability of one drug product with another and, when established, indicates whether the rate and extent of absorption of a generic drug in the body are substantially equivalent to the previously approved drug. "Bioavailability" establishes the rate and extent of absorption, as determined by the time dependent concentrations of a drug product in the bloodstream needed to produce a therapeutic effect. The ANDA drug development and approval process generally takes three to four years which is less time than the NDA drug development and approval process since the ANDA process does not require new clinical trials establishing the safety and efficacy of the drug product.

Supplemental NDAs or ANDAs are required for, among other things, approval to transfer certain products from one manufacturing site to another and may be under review for a year or more. In addition, certain products may only be approved for transfer once new bioequivalency studies are conducted or other requirements are satisfied.

To obtain FDA approval of both NDAs and ANDAs, our manufacturing procedures and operations must conform to FDA quality system and control requirements generally referred to as current Good Manufacturing Practices ("cGMP"), as defined in Title 21 of the U.S. Code of Federal Regulations. These regulations encompass all aspects of the production process from receipt and qualification of components to distribution procedures for finished products. They are evolving standards; thus, we must continue to expend substantial time, money and effort in all production and quality control areas to maintain compliance. The evolving and complex nature of regulatory requirements, the broad authority and discretion of the FDA, and the generally high level of regulatory oversight results in the continuing possibility that we may be adversely affected by regulatory actions despite our efforts to maintain compliance with regulatory requirements.

We are subject to the periodic inspection of our facilities, procedures and operations and/or the testing of our products by the FDA, the DEA and other authorities, which conduct periodic inspections to assess compliance with applicable regulations. In addition, in connection with its review of our applications for new products, the FDA conducts pre-approval and post-approval reviews and plant inspections to determine whether our systems and processes comply with cGMP and other FDA regulations. Among other things, the FDA may withhold approval of NDAs, ANDAs or other product applications of a facility if deficiencies are found at that facility. Vendors that supply finished products or components to us that we use to manufacture, package and label products are subject to similar regulation and periodic inspections.

Following such inspections, the FDA may issue notices on Form 483 and Warning Letters that could cause us to modify certain activities identified during the inspection. A Form 483 notice is generally issued at the conclusion of an FDA inspection and lists conditions the FDA investigators believe may violate cGMP or other FDA regulations. FDA guidelines specify that a Warning Letter be issued only for violations of "regulatory significance" for which the failure to adequately and promptly achieve correction may be expected to result in an enforcement action.

Our Corona, California facility is currently subject to a consent decree of permanent injunction. See also "Manufacturing, Suppliers and Materials" discussion above, "ITEM 1A. RISK FACTORS — Risks Related to Our Business — Extensive industry regulation has had, and will continue to have, a significant impact on our

[Table of Contents](#)

business, especially our product development, manufacturing and distribution capabilities." and *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

Failure to comply with FDA and other governmental regulations can result in fines, unanticipated compliance expenditures, recall or seizure of products, total or partial suspension of production and/or distribution, suspension of the FDA's review of NDAs, ANDAs or other product application enforcement actions, injunctions and criminal prosecution. Under certain circumstances, the FDA also has the authority to revoke previously granted drug approvals. Although we have internal compliance programs, if these programs do not meet regulatory agency standards or if our compliance is deemed deficient in any significant way, it could have a material adverse effect on us. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development, manufacturing and distribution capabilities." in this Annual Report.

The Generic Drug Enforcement Act of 1992 established penalties for wrongdoing in connection with the development or submission of an ANDA. Under this Act, the FDA has the authority to permanently or temporarily bar companies or individuals from submitting or assisting in the submission of an ANDA, and to temporarily deny approval and suspend applications to market generic drugs. The FDA may also suspend the distribution of all drugs approved or developed in connection with certain wrongful conduct and/or withdraw approval of an ANDA and seek civil penalties. The FDA can also significantly delay the approval of any pending NDA, ANDA or other regulatory submissions under the Fraud, Untrue Statements of Material Facts, Bribery and Illegal Gratuities Policy Act.

U.S. Government reimbursement programs include Medicare, Medicaid, TriCare, and State Pharmacy Assistance Programs established according to statute, government regulations and policy. Federal law requires that all pharmaceutical manufacturers, as a condition of having their products receive federal reimbursement under Medicaid, must pay rebates to state Medicaid programs on units of their pharmaceuticals that are dispensed to Medicaid beneficiaries. With enactment of The Patient Protection and Affordable Care Act, ("PPACA"), the required per-unit rebate for products marketed under ANDAs increased from 11% of the average manufacturer price to approximately 13%. Additionally, for products marketed under NDAs, the manufacturers rebate will increase from 15.1% to 23.1% of the average manufacturer price, or the difference between the average manufacturer price and the lowest net sales price to a non-government customer during a specified period. In some states, supplemental rebates are additionally required as a condition of including the manufacturer's drug on the state's Preferred Drug List.

PPACA also made substantial changes to reimbursement when seniors reach the Medicare Part D coverage gap "donut hole". By 2020, Medicare beneficiaries will pay just 25% of drug costs when they reach the coverage threshold — the same percentage they were responsible for before they reached that threshold.

The cost of closing the donut hole is being borne by generic and brand drug companies. Brand drug manufacturers must provide a 50% discount on their drugs, beginning in 2011. Additionally, beginning in 2013, the government will begin providing subsidies for brand-name drugs bought by seniors who enter the coverage gap. The government's share will start at 2.5%, but will increase to 25% by 2020. At that point, the combined industry discounts and government subsidies will add up to 75% of brand-name drug costs. Generic drugs, which cost less than their brand-name counterparts, are treated different from brand drugs. Beginning in 2011, government subsidies will cover 7% of generic drug costs. The government will then subsidize additional portions each year until 2020, when federal subsidies will cover 75% of generic drug costs. By 2020, the donut hole will be completely closed through these manufacturers' subsidies.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "MMA") requires that manufacturers report data to the Centers for Medicare and Medicaid Services ("CMS") on pricing of drugs and biologicals reimbursed under Medicare Part B. These are generally drugs, such as injectable products, that are administered "incident to" a physician service, and in general are not self-administered. Effective January 1, 2005, average selling price ("ASP") became the basis for reimbursement to physicians and suppliers for drugs and biologicals covered under Medicare Part B, replacing the average wholesale price ("AWP") provided and

[Table of Contents](#)

published by pricing services. In general, we must comply with all reporting requirements for any drug or biological that is separately reimbursable under Medicare. Watson's INFeD[®] and Trelstar[®] products are reimbursed under Medicare Part B and, as a result, we provide ASP data on these products to CMS on a quarterly basis.

Under Part D of the MMA, some Medicare beneficiaries are eligible to obtain subsidized prescription drug coverage from private sector providers. Usage of pharmaceuticals has increased as a result of the expanded access to medicines afforded by the Medicare prescription drug benefit. However, such sales increases have been offset by increased pricing pressures due to the enhanced purchasing power of the private sector providers who negotiate on behalf of Medicare beneficiaries. It is anticipated that further pricing pressures will continue into 2011 and beyond.

The Deficit Reduction Act of 2005 ("DRA") mandated a number of changes in the Medicaid program, including the use of Average Manufacturers Price ("AMP") as the basis for reimbursement to pharmaceutical companies that dispense generic drugs under the Medicaid program. Three health care reform bills passed in 2010 significantly changed the definition of AMP, effective October 1, 2010. These legislative changes were part of PPACA, the Health Care and Education Reconciliation Act, and the FAA Air Transportation Modernization & Safety Improvement Act ("Transportation Bill"). In PPACA, Congress substantially revised the definition of AMP to, among other things, narrow the scope of prices included in the calculation of AMP to those paid to a manufacturer by wholesalers for drugs distributed to retail community pharmacies or by retail community pharmacies that purchase directly from manufacturers. In August 2010, Congress further amended the definition of AMP to specify that the exclusion of certain classes of trade from AMP does not apply to inhalation, infusion, instilled, implanted, or injected drugs that typically are not dispensed to retail community pharmacies. PPACA also requires disclosure of weighted average AMP instead of manufacturer AMP, which was previously required. The impact of this new legislation is that there will likely be increases in Medicaid reimbursement to pharmacies for generics. These changes became effective on October 1, 2010.

These new laws replaced the reimbursement guidelines that had been established under the DRA. On November 9, 2010, CMS issued a final rule withdrawing and amending regulations that have governed the calculation of AMP and the establishment of federal upper limits since October 2007. The regulations were withdrawn to mandate AMP calculation under the recently revised drug rebate statute, but no replacement regulations have yet been proposed. The withdrawal required manufacturers to base October 2010, and subsequent month's AMPs on the statutory language until official guidance is issued. CMS anticipates that it will offer guidance by the second quarter of 2011.

In the absence of regulatory guidance governing the AMP calculation, CMS has instructed pharmaceutical manufacturers to base their AMP calculations on the definitions set forth in the statute, as amended by the PPACA, the Health Care and Education Reconciliation Act, and the Transportation Bill. Without the benefit of interpretive guidance from CMS, Watson has adopted mechanisms to ensure that we are calculating and reporting AMP in a manner that is consistent with the statute's text and intent.

As a result of these changes, in December of 2010, the National Association of Chain Drugstores ("NACDS") and the National Community Pharmacists Association dropped their 2007 lawsuit that was previously blocking the implementation of the AMP rule.

Twenty-six states are currently challenging the constitutionality of PPACA. Ultimate resolution of this matter remains uncertain.

There has been enhanced political attention, governmental scrutiny and litigation at the federal and state levels of the prices paid or reimbursed for pharmaceutical products under Medicaid, Medicare and other government programs. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business — Investigations of the calculation of average wholesale prices may adversely affect our business." and *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

In order to assist us in commercializing products, we have obtained from government authorities and private health insurers and other organizations, such as Health Maintenance Organizations ("HMOs") and

[Table of Contents](#)

Managed Care Organizations ("MCOs"), authorization to receive reimbursement at varying levels for the cost of certain products and related treatments. Third party payers increasingly challenge pricing of pharmaceutical products. The trend toward managed healthcare in the U.S., the growth of organizations such as HMOs and MCOs and legislation to reform healthcare and government insurance programs could significantly influence the purchase of pharmaceutical products, resulting in lower prices and a reduction in product demand. Such cost containment measures and healthcare legislation could affect our ability to sell our products and may have a material adverse effect on our business, results of operations, financial condition and cash flows. Due to the uncertainty surrounding reimbursement of newly approved pharmaceutical products, reimbursement may not be available for some of our products. Additionally, any reimbursement granted may not be maintained or limits on reimbursement available from third-party payers may reduce the demand for, or negatively affect the price of, those products.

Federal, state, local and foreign laws of general applicability, such as laws regulating working conditions, also govern us. In addition, we are subject, as are all manufacturers generally, to numerous and increasingly stringent federal, state and local environmental laws and regulations concerning, among other things, the generation, handling, storage, transportation, treatment and disposal of toxic and hazardous substances and the discharge of pollutants into the air and water. Environmental permits and controls are required for some of our operations, and these permits are subject to modification, renewal and revocation by the issuing authorities. Our environmental capital expenditures and costs for environmental compliance may increase in the future as a result of changes in environmental laws and regulations or increased manufacturing activities at any of our facilities. We could be adversely affected by any failure to comply with environmental laws, including the costs of undertaking a clean-up at a site to which our wastes were transported.

As part of the MMA, companies are required to file with the U.S. Federal Trade Commission ("FTC") and the Department of Justice certain types of agreements entered into between brand and generic pharmaceutical companies related to the manufacture, marketing and sale of generic versions of brand drugs. This requirement could affect the manner in which generic drug manufacturers resolve intellectual property litigation and other disputes with brand pharmaceutical companies, and could result generally in an increase in private-party litigation against pharmaceutical companies. The impact of this requirement, and the potential private-party lawsuits associated with arrangements between brand name and generic drug manufacturers, is uncertain and could adversely affect our business. For example, in January 2009, the FTC and the State of California filed a lawsuit against us alleging that our settlement with Solvay related to our ANDA for a generic version of AndroGel[®] is unlawful. Beginning in February 2009, several private parties purporting to represent various classes of plaintiffs filed similar lawsuits. Additionally, we have received requests for information, in the form of civil investigative demands or subpoenas, from the FTC, and are subject to ongoing FTC investigations, concerning our settlement with Cephalon related to our ANDA for a generic version of Provigil[®]. Any adverse outcome of these or other FTC investigations or actions could have a material adverse effect on our business, results of operations, financial condition and cash flows. See "ITEM 1A. RISK FACTORS — Risks Related to Our Business— Federal regulation of arrangements between manufacturers of brand and generic products could adversely affect our business." Also refer to *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

Continuing studies of the proper utilization, safety and efficacy of pharmaceuticals and other health care products are being conducted by industry, government agencies and others. Such studies, which increasingly employ sophisticated methods and techniques, can call into question the utilization, safety and efficacy of previously marketed products and in some cases have resulted, and may in the future result, in the discontinuance of their marketing.

Our Distribution operations and our customers are subject to various regulatory requirements, including requirements from the DEA, FDA, and state boards of pharmacy and city and county health regulators, among others. These include licensing, registration, recordkeeping, security and reporting requirements. In particular, several states and the federal government have begun to enforce anti-counterfeit drug pedigree laws which require the tracking of all transactions involving prescription drugs beginning with the manufacturer, through the supply chain, and down to the pharmacy or other health care provider dispensing or administering

[Table of Contents](#)

prescription drug products. For example, effective July 1, 2006, the Florida Department of Health began enforcement of the drug pedigree requirements for distribution of prescription drugs in the State of Florida. Pursuant to Florida law and regulations, wholesalers and distributors, including our subsidiary, Anda, are required to maintain records documenting the chain of custody of prescription drug products they distribute beginning with the purchase of such products from the manufacturer. These entities are required to provide documentation of the prior transaction(s) to their customers in Florida, including pharmacies and other health care entities. Several other states have proposed or enacted legislation to implement similar or more stringent drug pedigree requirements. In addition, federal law requires that a "non-authorized distributor of record" must provide a drug pedigree documenting the prior purchase of a prescription drug from the manufacturer or from an "authorized distributor of record." In cases where the wholesaler or distributor selling the drug product is not deemed an "authorized distributor of record," it would need to maintain such records. The FDA had announced its intent to impose additional drug pedigree requirements (e.g., tracking of lot numbers and documentation of all transactions) through implementation of drug pedigree regulations which were to have taken effect on December 1, 2006. However, a federal appeals court has issued a preliminary injunction to several wholesale distributors granting an indefinite stay of these regulations pending a challenge to the regulations by these wholesale distributors.

Environmental Matters

We are subject to federal, state, local and foreign environmental laws and regulations. We believe that our operations comply in all material respects with applicable environmental laws and regulations in each jurisdiction where we have a business presence. Although we continue to make capital expenditures for environmental protection, we do not anticipate any significant expenditure in order to comply with such laws and regulations that would have a material impact on our earnings or competitive position. We are not aware of any pending litigation or significant financial obligations arising from current or past environmental practices that are likely to have a material adverse effect on our financial position. We cannot assure you, however, that environmental problems relating to facilities owned or operated by us will not develop in the future, and we cannot predict whether any such problems, if they were to develop, could require significant expenditures on our part. In addition, we are unable to predict what legislation or regulations may be adopted or enacted in the future with respect to environmental protection and waste disposal.

Seasonality

There are no significant seasonal aspects to our business except in Western Europe. During the months of July and August our operations in Western Europe experience significantly lower sales due to pharmacy closures and representatives on summer vacations.

Backlog

Due to the relatively short lead-time required to fill orders for our products, backlog of orders is not material to our business.

Employees

As of December 31, 2010, we had approximately 6,030 employees. Of our employees, approximately 830 are engaged in R&D, 1,850 in manufacturing, 1,070 in quality assurance and quality control, 1,380 in sales, marketing and distribution, and 900 in administration.

ITEM 1A. RISK FACTORS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

Risks Related to Our Business

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

Risks Associated With Investing In the Business of Watson

Our operating results and financial condition may fluctuate.

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

- development of new competitive products or generics by others;
- the timing and receipt of approvals by the FDA and other regulatory authorities, including foreign regulatory authorities;
- the failure to obtain, delay in obtaining or restrictions or limitations on approvals from the FDA or other foreign regulatory authorities;
- difficulties or delays in resolving FDA-observed deficiencies at our manufacturing facilities, which could delay our ability to obtain approvals of pending FDA product applications;

Table of Contents

- delays or failures in clinical trials that affect our ability to achieve FDA approvals or approvals from other foreign regulatory authorities;
- serious or unexpected health or safety concerns with our products or product candidates;
- changes in the amount we spend to develop, acquire or license new products, technologies or businesses;
- changes in the amount we spend to promote our products;
- delays between our expenditures to acquire new products, technologies or businesses and the generation of revenues from those acquired products, technologies or businesses;
- changes in treatment practices of physicians that currently prescribe our products;
- changes in coverage and reimbursement policies of health plans and other health insurers, including changes that affect newly developed or newly acquired products;
- changes in laws and regulations concerning coverage and reimbursement of pharmaceutical products, including changes to Medicare, Medicaid, and similar state programs;
- increases in the cost of raw materials used to manufacture our products;
- manufacturing and supply interruptions, including failure to comply with manufacturing specifications;
- the effect of economic changes in hurricane, monsoon, earthquake and other natural disaster-affected areas;
- the impact of third party patents and other intellectual property rights which we may be found to infringe, or may be required to license, and the potential damages or other costs we may be required to pay as a result of a finding that we infringe such intellectual property rights or a decision that we are required to obtain a license to such intellectual property rights;
- the mix of products that we sell during any time period;
- lower than expected demand for our products;
- our responses to price competition;
- our ability to successfully integrate and commercialize the products, technologies and businesses we acquire or license, as applicable;
- expenditures as a result of legal actions;
- market acceptance of our products;
- the impairment and write-down of goodwill or other intangible assets;
- disposition of our primary products, technologies and other rights;
- termination or expiration of, or the outcome of disputes relating to, trademarks, patents, license agreements and other rights;
- changes in insurance rates for existing products and the cost of insurance for new products;
- general economic and industry conditions, including changes in interest rates affecting returns on cash balances and investments that affect customer demand;
- our level of R&D activities;
- impairment or write-down of investments;
- costs and outcomes of any tax audits;
- fluctuations in foreign currency exchange rates;
- costs and outcomes of any litigation involving intellectual property, drug pricing or reimbursement, product liability, customers or other issues;

[Table of Contents](#)

- timing of revenue recognition related to licensing agreements and/or strategic collaborations; and
- risks related to the growth of our business across numerous countries world-wide and the inherent international business risks.

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

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

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

- developing, testing and manufacturing products in compliance with regulatory standards in a timely manner;
- receiving requisite regulatory approvals for such products in a timely manner or at all;
- the availability, on commercially reasonable terms, of raw materials, including API and other key ingredients;
- developing and commercializing a new product is time consuming, costly and subject to numerous factors, including legal actions brought by our competitors, that may delay or prevent the development and commercialization of new products;
- experiencing delays or unanticipated costs;
- experiencing delays as a result of limited resources at FDA or other regulatory agencies;
- changing review and approval policies and standards at FDA and other regulatory agencies; and
- commercializing generic products may be substantially delayed by the listing with the FDA of patents that have the effect of potentially delaying approval of the generic product by up to 30 months.

As a result of these and other difficulties, products currently in development by us may or may not receive timely regulatory approvals, or approvals at all, necessary for marketing by us or other third-party partners. This risk particularly exists with respect to the development of proprietary products because of the uncertainties, higher costs and lengthy time frames associated with research and development of such products and the inherent unproven market acceptance of such products. Additionally, we face heightened risks in connection with our development of extended release or controlled release generic products because of the technical difficulties and regulatory requirements related to such products. Additionally, with respect to generic products for which we are the first applicant to request approval on the basis that an innovator patent is invalid or not infringed (a paragraph IV filing), our ability to obtain 180 days of generic market exclusivity may be contingent on our ability to obtain FDA approval or tentative approval within 30 months of FDA's acceptance of our application for filing. We therefore risk forfeiting such market exclusivity if we are unable to obtain such approval or tentative approval on a timely basis. If any of our products are not timely approved or, when acquired or developed and approved, cannot be successfully manufactured or timely commercialized, our operating results could be adversely affected. We cannot guarantee that any investment we make in developing products will be recouped, even if we are successful in commercializing those products.

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

Developing and commercializing brand pharmaceutical products is generally more costly than generic products. In the future, we anticipate continuing our product development expenditures for our Global Brands business segment. For example in 2010, we acquired rights to Prochieve® 8% vaginal progesterone gel to reduce the risk of preterm birth in women with a short cervix. We plan to submit an NDA for FDA approval

[Table of Contents](#)

of this product in 2011. We cannot be sure this or other business expenditures will result in the successful discovery, development or launch of brand products that will prove to be commercially successful or will improve the long-term profitability of our business. If such business expenditures do not result in successful discovery, development or launch of commercially successful brand products our results of operations and financial condition could be materially adversely affected.

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

We regularly review potential acquisitions of technologies, products and businesses complementary to our business. Acquisitions typically entail many risks and could result in difficulties in integrating operations, personnel, technologies and products. If we are not able to successfully integrate our acquisitions, we may not obtain the advantages and synergies that the acquisitions were intended to create, which may have a material adverse effect on our business, results of operations, financial condition and cash flows, our ability to develop and introduce new products and the market price of our stock. In addition, in connection with acquisitions, we could experience disruption in our business, technology and information systems, customer or employee base, including diversion of management's attention from our continuing operations. There is also a risk that key employees of companies that we acquire or key employees necessary to successfully commercialize technologies and products that we acquire may seek employment elsewhere, including with our competitors. Furthermore, there may be overlap between our products or customers and the companies that we acquire that may create conflicts in relationships or other commitments detrimental to the integrated businesses. If we are unable to successfully integrate products, technologies, businesses or personnel that we acquire, we could incur significant impairment charges or other adverse financial consequences.

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

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

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

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

Our success with the brand products that we develop will depend, in part, on our ability to obtain patent protection for these products. We currently have a number of U.S. and foreign patents issued and pending. However, issuance of a patent is not conclusive evidence of its validity or enforceability. We cannot be sure that we will receive patents for any of our pending patent applications or any patent applications we may file in the future, or that our issued patents will be upheld if challenged. If our current and future patent applications are not approved or, if approved, our patents are not upheld in a court of law if challenged, it may reduce our ability to competitively exploit our patented products. Also, such patents may or may not provide competitive advantages for their respective products or they may be challenged or circumvented by our competitors, in which case our ability to commercially market these products may be diminished. Patents covering our Androderm[®] and INFed[®] products have expired and we have no further patent protection on

[Table of Contents](#)

these products. Therefore, it is possible that a competitor may launch a generic version of Androderm® and/or INFed® at any time, which would result in a significant decline in that product's revenue and profit. Both of these products were significant contributors to our Global Brands business in 2010.

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

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

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

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

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

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

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

Certain of our competitors have recently challenged our ability to distribute Authorized Generics during the competitors' 180-day period of ANDA exclusivity under the Hatch-Waxman Act. Under the challenged arrangements, we have obtained rights to market and distribute under a brand manufacturer's NDA a generic alternative of the brand product. Some of our competitors have challenged the propriety of these arrangements by filing Citizen Petitions with the FDA, initiating lawsuits alleging violation of the antitrust and consumer protection laws, and seeking legislative intervention. For example, in February 2011, legislation was introduced in the U.S. Senate that would prohibit the marketing of Authorized Generics during the 180-day period of ANDA exclusivity under the Hatch-Waxman Act. If distribution of Authorized Generic versions of brand products is otherwise restricted or found unlawful, our results of operations, financial condition and cash flows could be materially adversely affected.

[Table of Contents](#)

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

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

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

The manufacture, use and sale of new products that are the subject of conflicting patent rights have been the subject of substantial litigation in the pharmaceutical industry. These lawsuits relate to the validity and infringement of patents or proprietary rights of third parties. We may have to defend against charges that we violated patents or proprietary rights of third parties. This is especially true in the case of generic products on which the patent covering the brand product is expiring, an area where infringement litigation is prevalent, and in the case of new brand products where a competitor has obtained patents for similar products. Litigation may be costly and time-consuming, and could divert the attention of our management and technical personnel. In addition, if we infringe the rights of others, we could lose our right to develop, manufacture or market products or could be required to pay monetary damages or royalties to license proprietary rights from third parties. For example, we are engaged in litigation with Bayer Pharmaceuticals concerning whether our Zarahtm product infringes Bayer's U.S. Patent Number 5,569,652, and we continue to manufacture and market our Zarahtm product during the pendency of the litigation. Although the parties to patent and intellectual property disputes in the pharmaceutical industry have often settled their disputes through licensing or similar arrangements, the costs associated with these arrangements may be substantial and could include ongoing royalties. Furthermore, we cannot be certain that the necessary licenses would be available to us on commercially reasonable terms, or at all. As a result, an adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could result in substantial monetary damage awards and could prevent us from manufacturing and selling a number of our products, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

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

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

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

[Table of Contents](#)

Our distribution operations compete directly with significant customers of our generic and brand businesses.

In our Distribution business, our main competitors are McKesson Corporation, AmerisourceBergen Corporation and Cardinal Health, Inc. These companies are significant customers of our Global Generics and Global Brands operations and collectively accounted for approximately 23% of our annual net revenues in 2010. Our activities related to our Distribution business, as well as the acquisition of other businesses that compete with our customers, may result in the disruption of our business, which could harm relationships with our current customers, employees or suppliers, and could adversely affect our expenses, pricing, third-party relationships and revenues. Further, a loss of a significant customer of our Global Generics or Global Brands operations could have a material adverse effect on our business, results of operations, financial condition and cash flows.

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

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

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

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

Consistent with industry practice we, like many generic product manufacturers, have liberal return policies and have been willing to give customers post-sale inventory allowances. Under these arrangements, from time to time, we may give our customers credits on our generic products that our customers hold in inventory after we have decreased the market prices of the same generic products. Therefore, if new competitors enter the marketplace and significantly lower the prices of any of their competing products, we may reduce the price of our product. As a result, we may be obligated to provide significant credits to our

[Table of Contents](#)

customers who are then holding inventories of such products, which could reduce sales revenue and gross margin for the period the credit is provided. Like our competitors, we also give credits for chargebacks to wholesale customers that have contracts with us for their sales to hospitals, group purchasing organizations, pharmacies or other retail customers. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to us by our wholesale customer for a particular product and the negotiated price that the wholesaler's customer pays for that product. Although we establish reserves based on our prior experience and our best estimates of the impact that these policies may have in subsequent periods, we cannot ensure that our reserves are adequate or that actual product returns, allowances and chargebacks will not exceed our estimates, which could have a material adverse effect on our results of operations, financial condition, cash flows and the market price of our stock.

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

Many government and third-party payers, including Medicare, Medicaid, HMOs and MCOs, have historically reimbursed doctors, pharmacies and others for the purchase of certain prescription drugs based on a drug's AWP or wholesale average cost ("WAC"). In the past several years, state and federal government agencies have conducted ongoing investigations of manufacturers' reporting practices with respect to AWP and WAC, in which they have suggested that reporting of inflated AWP's or WAC's have led to excessive payments for prescription drugs. For example, beginning in July 2002, we and certain of our subsidiaries, as well as numerous other pharmaceutical companies, were named as defendants in various state and federal court actions alleging improper or fraudulent practices related to the reporting of AWP and/or WAC of certain products, and other improper acts, in order to increase prices and market shares. Additional actions are anticipated. These actions, if successful, could adversely affect us and may have a material adverse effect on our business, results of operations, financial condition and cash flows. See *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

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

The design, development, manufacture and sale of our products involve an inherent risk of product liability claims and the associated adverse publicity. Insurance coverage is expensive and may be difficult to obtain, and may not be available in the future on acceptable terms, or at all. We regularly monitor the use of our products for trends or increases in reports of adverse events or product complaints, and regularly report such matters to the FDA. In some, but not all, cases an increase in adverse event reports may be an indication that there has been a change in a product's specifications or efficacy. Such changes could lead to a recall of the product in question or, in some cases, increases in product liability claims related to the product in question. If the coverage limits for product liability insurance policies are not adequate or if certain of our products are excluded from coverage, a claim brought against us, whether covered by insurance or not, could have a material adverse effect on our business, results of operations, financial condition and cash flows. See *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

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

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

[Table of Contents](#)

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

A significant amount of our total assets is related to acquired intangibles and goodwill. As of December 31, 2010, the carrying value of our product rights and other intangible assets was approximately \$1.63 billion and the carrying value of our goodwill was approximately \$1.53 billion.

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

Our other significant intangible assets include acquired core technology and customer relationships, which are intangible assets with definite lives, our Anda trade name and acquired in-process research and development ("IPR&D") intangibles, acquired in recent business acquisitions, which are intangible assets with indefinite lives.

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

Goodwill, our Anda trade name intangible asset and our IPR&D intangible assets are tested for impairment annually and when events occur or circumstances change that could potentially reduce the fair value of the reporting unit or intangible asset. Impairment testing compares the fair value of the reporting unit or intangible asset to its carrying amount. A goodwill, trade name or IPR&D impairment, if any, would be recorded in operating income and could have a material adverse effect on our results of operations and financial condition. During the fourth quarter of 2010, the Company recorded a \$28.6 million impairment charge related to certain IPR&D assets acquired in the Arrow Acquisition.

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

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

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

The manufacture of certain of our products and product candidates, particularly our controlled-release products, transdermal products, and our oral contraceptive products, is more difficult than the manufacture of immediate-release products. Successful manufacturing of these types of products requires precise

Table of Contents

manufacturing process controls, API that conforms to very tight tolerances for specific characteristics and equipment that operates consistently within narrow performance ranges. Manufacturing complexity, testing requirements, and safety and security processes combine to increase the overall difficulty of manufacturing these products and resolving manufacturing problems that we may encounter.

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

Our substantial debt and other financial obligations could impair our financial condition and our ability to fulfill our debt obligations. Any refinancing of this substantial debt could be at significantly higher interest rates.

As of December 31, 2010, we had total debt of approximately \$1.0 billion. Our substantial indebtedness and other financial obligations could:

- impair our ability to obtain financing in the future for working capital, capital expenditures, acquisitions or general corporate purposes;
- have a material adverse effect on us if we fail to comply with financial and affirmative and restrictive covenants in our debt agreements and an event of default occurs as a result of a failure that is not cured or waived;
- require us to dedicate a substantial portion of our cash flow for interest payments on our indebtedness and other financial obligations, thereby reducing the availability of our cash flow to fund working capital and capital expenditures;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
- place us at a competitive disadvantage compared to our competitors that have proportionally less debt.

If we are unable to meet our debt service obligations and other financial obligations, we could be forced to restructure or refinance our indebtedness and other financial transactions, seek additional equity capital or sell our assets. We might then be unable to obtain such financing or capital or sell our assets on satisfactory terms, if at all. Any refinancing of our indebtedness could be at significantly higher interest rates, and/or incur significant transaction fees.

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

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

[Table of Contents](#)

revocation by the issuing authorities. Any modification, revocation or non-renewal of our environmental permits could have a material adverse effect on our ongoing operations, business and financial condition. Our environmental capital expenditures and costs for environmental compliance may increase in the future as a result of changes in environmental laws and regulations or increased development or manufacturing activities at any of our facilities.

Global economic conditions could harm us.

Recent global market and economic conditions have been unprecedented and challenging with tighter credit conditions and recession in most major economies during 2009, 2010 and continuing in 2011. Continued concerns about the systemic impact of potential long-term and wide-spread recession, energy costs, geopolitical issues, the availability and cost of credit, and the global real estate markets have contributed to increased market volatility and diminished expectations for western and emerging economies. These conditions, combined with volatile oil prices, declining business and consumer confidence and increased unemployment, have contributed to volatility of unprecedented levels.

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

Our foreign operations may become less attractive if political and diplomatic relations between the United States and any country where we conduct business operations deteriorates.

The relationship between the United States and the foreign countries where we conduct business operations may weaken over time. Changes in the state of the relations between any such country and the United States are difficult to predict and could adversely affect our future operations. This could lead to a decline in our profitability. Any meaningful deterioration of the political and diplomatic relations between the United States and the relevant country could have a material adverse effect on our operations.

Our global operations expose us to risks and challenges associated with conducting business internationally.

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

[Table of Contents](#)

In addition to the foregoing, engaging in international business inherently involves a number of other difficulties and risks, including:

- longer payment cycles and difficulties in enforcing agreements and collecting receivables through certain foreign legal systems;
- political and economic instability;
- potentially adverse tax consequences, tariffs, customs charges, bureaucratic requirements and other trade barriers;
- difficulties and costs of staffing and managing foreign operations;
- difficulties protecting or procuring intellectual property rights; and
- fluctuations in foreign currency exchange rates.

These factors or any combination of these factors may adversely affect our revenue or our overall financial performance.

We have exposure to foreign tax liabilities.

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

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

We do business and generate sales in numerous countries outside the United States. As such, foreign currency fluctuations may affect the costs that we incur in such international operations. Some of our operating expenses are incurred in non-U.S. dollar currencies. The appreciation of non-U.S. dollar currencies in those countries where we have operations against the U.S. dollar could increase our costs and could harm our results of operations and financial condition.

Risks Relating To Investing In the Pharmaceutical Industry

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

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

Under these regulations, we are subject to periodic inspection of our facilities, procedures and operations and/or the testing of our products by the FDA, the DEA and other authorities, which conduct periodic inspections to confirm that we are in compliance with all applicable regulations. In addition, the FDA and foreign regulatory agencies conduct pre-approval and post-approval reviews and plant inspections to determine whether our systems and processes are in compliance with cGMP and other regulations. Following such inspections, the FDA or other agency may issue observations, notices, citations and/or Warning Letters that could cause us to modify certain activities identified during the inspection. FDA guidelines specify that a Warning Letter is issued only for violations of "regulatory significance" for which the failure to adequately

[Table of Contents](#)

and promptly achieve correction may be expected to result in an enforcement action. We are also required to report adverse events associated with our products to FDA and other regulatory authorities. Unexpected or serious health or safety concerns would result in product liability claims, labeling changes, recalls, market withdrawals or other regulatory actions.

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

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

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

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

As part of the MMA, companies are required to file with the FTC and the Department of Justice certain types of agreements entered into between brand and generic pharmaceutical companies related to the manufacture, marketing and sale of generic versions of brand drugs. This requirement, as well as new legislation pending in U.S. Congress related to settlement between brand and generic drug manufacturers, could affect the manner in which generic drug manufacturers resolve intellectual property litigation and other disputes with brand pharmaceutical companies and could result generally in an increase in private-party litigation against pharmaceutical companies or additional investigations or proceedings by the FTC or other governmental authorities. The impact of this requirement, the pending legislation and the potential private-party lawsuits associated with arrangements between brand name and generic drug manufacturers, is uncertain and could adversely affect our business. For example, in January 2009, the FTC and the State of California filed a lawsuit against us alleging that our settlement with Solvay related to our ANDA for a generic version of AndroGel[®] is unlawful. From February 2009 through September 2010, numerous private parties purporting to represent various classes of plaintiffs filed similar lawsuits. Additionally, we have received requests for information, in the form of civil investigative demands or subpoenas, from the FTC, and are subject to ongoing FTC investigations, concerning our settlement with Cephalon related to our ANDA for a generic version of Provigil[®]. We have also received requests for information in connection with similar investigations into settlements and other arrangements between competing pharmaceutical companies by the European Competition Commission. Any adverse outcome of these actions or investigations, or actions or investigations related to other settlements we have entered into, could have a material adverse effect on our business, results of operations, financial condition and cash flows. See *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

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

In the United States, most of our products are reimbursed under federal and state health care programs such as Medicaid, Medicare, TriCare, and or state pharmaceutical assistance programs. Many foreign countries have similar laws. Federal and state laws designed to prevent fraud and abuse under these programs prohibit pharmaceutical companies from offering valuable items or services to customers or potential customers to induce them to buy, prescribe, or recommend Watson's product (the so-called "antikickback" laws). Exceptions are provided for discounts and certain other arrangements if specified requirements are met. Other federal and state laws, and similar foreign laws, not only prohibit us from submitting any false information to government reimbursement programs but also prohibit us and our employees from doing anything to cause, assist, or encourage our customers to submit false claims for payment to these programs. Violations of the fraud and abuse laws may result in severe penalties against the responsible employees and Watson, including jail sentences, large fines, and the exclusion of Watson products from reimbursement under federal and state programs. Watson is committed to conducting the sales and marketing of its products in compliance with the healthcare fraud and abuse laws, but certain applicable laws may impose liability even in the absence of specific intent to defraud. Furthermore, should there be ambiguity, a governmental authority may take a position contrary to a position we have taken, or should an employee violate these laws without our knowledge, a governmental authority may impose civil and/or criminal sanctions. For example, in December 2009, we learned that numerous pharmaceutical companies, including certain subsidiaries of the Company, have been named as defendants in a qui tam action pending in the United States District Court for the District of Massachusetts alleging that the defendants falsely reported to the United States that certain pharmaceutical products were eligible for Medicaid reimbursement and thereby allegedly caused false claims for payment to be made through the Medicaid program. Any adverse outcome of this action, or the imposition of penalties or sanctions for failing to comply with the fraud and abuse laws, could adversely affect us and may have a material adverse effect on our business, results of operations, financial condition and cash flows. See *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

[Table of Contents](#)

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

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

There is uncertainty surrounding implementation of legislation involving payments for pharmaceuticals under government programs such as Medicare, Medicaid and Tricare. Depending on how existing provisions are implemented, the methodology for certain payment rates and other computations under the Medicaid Drug Rebate program reimbursements may be reduced or not be available for some of Watson's products. Additionally, any reimbursement granted may not be maintained or limits on reimbursement available from third-party payers may reduce demand for, or negatively affect the price of those products. Ongoing uncertainty and legal challenges to the PPACA, including but not limited to, modification in calculation of rebates, mandated financial or other contributions to close the Medicare Part D coverage gap "donut hole", calculation of AMP, and other provisions could have a material adverse effect on our business. In addition, various legislative and regulatory initiatives in states, including proposed modifications to reimbursements and rebates, product pedigree and tracking, pharmaceutical waste "take-back" initiatives, and therapeutic category generic substitution carve-out legislation may also have a negative impact on the Company. Watson maintains a full-time government affairs department in Washington, DC, which is responsible for coordinating state and federal legislative activities, and place a major emphasis in terms of management time and resources to ensure a fair and balance legislative and regulatory arena.

PPACA also extended Medicaid rebates to Medicaid MCOs. MCO rebates may have a significant impact on our brand portfolio. Medicaid Managed care enrollment is over 70% of total Medicaid enrollment. This provision is likely to increase manufacturers' Medicaid Rebate liability substantially, particularly in states with large Medicaid managed care enrollment (e.g., Michigan, Kentucky, Colorado, Arizona). The effective date of this was January 1, 2010.

The pharmaceutical industry is highly competitive and our future revenue growth and profitability are dependent on our timely development and launches of new products ahead of our competitors.

We face strong competition in our Global Generics, Global Brands and Distribution businesses. The intensely competitive environment requires an ongoing, extensive search for technological innovations and the ability to market products effectively, including the ability to communicate the effectiveness, safety and value of brand products to healthcare professionals in private practice, group practices and MCOs. Our competitors vary depending upon product categories, and within each product category, upon dosage strengths and drug-delivery systems. Based on total assets, annual revenues, and market capitalization, we are smaller than certain of our national and international competitors in the brand and distribution product arenas. Most of our competitors have been in business for a longer period of time than us, have a greater number of products on the market and have greater financial and other resources than we do. Furthermore, recent trends in this industry are toward further market consolidation of large drug companies into a smaller number of very large entities, further concentrating financial, technical and market strength and increasing competitive pressure in the industry. If we directly compete with them for the same markets and/or products, their financial strength could prevent us from capturing a profitable share of those markets. It is possible that developments by our competitors will make our products or technologies noncompetitive or obsolete.

Table of Contents

Revenues and gross profit derived from the sales of generic pharmaceutical products tend to follow a pattern based on certain regulatory and competitive factors. As patents for brand name products and related exclusivity periods expire, the first generic manufacturer to receive regulatory approval for generic equivalents of such products is generally able to achieve significant market penetration. Therefore, our ability to increase or maintain revenues and profitability in our generics business is largely dependent on our success in challenging patents and developing non-infringing formulations of proprietary products. As competing manufacturers receive regulatory approvals on similar products or as brand manufacturers launch generic versions of such products (for which no separate regulatory approval is required), market share, revenues and gross profit typically decline, in some cases dramatically. Accordingly, the level of market share, revenue and gross profit attributable to a particular generic product normally is related to the number of competitors in that product's market and the timing of that product's regulatory approval and launch, in relation to competing approvals and launches. Consequently, we must continue to develop and introduce new products in a timely and cost-effective manner to maintain our revenues and gross margins. We may have fewer opportunities to launch significant generic products in the future, as the number and size of proprietary products that are subject to patent challenges is expected to decrease in the next several years compared to historical levels. Additionally, as new competitors enter the market, there may be increased pricing pressure on certain products, which would result in lower gross margins. This is particularly true in the case of certain Asian and other overseas generic competitors, who may be able to produce products at costs lower than the costs of domestic manufacturers. If we experience substantial competition from Asian or other overseas generic competitors with lower production costs, our profit margins will suffer.

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

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

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

For the year ended December 31, 2010, our three largest customers accounted for 14%, 11% and 6% respectively, of our net revenues. The loss of any of these customers could have a material adverse effect on our business, results of operations, financial condition and cash flows. In addition, none of our customers are party to any long-term supply agreements with us, and thus are able to change suppliers freely should they wish to do so.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

[Table of Contents](#)

ITEM 2. PROPERTIES

We conduct our operations using a combination of owned and leased properties.

Our owned properties consist of facilities used for R&D, manufacturing, distribution (including warehousing and storage), sales and marketing and administrative functions. The following table provides a summary of locations of our significant owned properties:

Location	Primary Use	Segment
Ambernath, India	Manufacturing, R&D	Global Generics
Carmel, New York	Manufacturing	Global Generics
Changzhou City, People's Republic of China	Manufacturing	Global Generics
Coleraine, United Kingdom	Manufacturing	Global Generics
Copiague, New York	Manufacturing, R&D	Global Generics
Corona, California	Manufacturing, R&D, Administration	Global Generics/Global Brands
Davie, Florida	Manufacturing, R&D, Administration	Global Generics/Global Brands
Grand Island, New York	Sales and Marketing, Administration	Distribution
Goa, India	Manufacturing	Global Generics
Gurnee, Illinois	Distribution	Global Generics/Global Brands
Melbourne, Australia	R&D, Administration	Global Generics
Mississauga, Canada	Manufacturing, R&D, Administration	Global Generics
Rio de Janeiro, Brazil	Manufacturing, Distribution, Sales and Marketing, Administration	Global Generics
Salt Lake City, Utah	Manufacturing, R&D	Global Generics/Global Brands
Shanghai, People's Republic of China	Sales and Marketing, Administration	Global Generics

Table of Contents

Properties that we lease include R&D, manufacturing, distribution (including warehousing and storage), sales and marketing, and administrative facilities. The following table provides a summary of locations of our significant leased properties:

<u>Location</u>	<u>Primary Use</u>	<u>Segment</u>
Birzebbuga, Malta	Manufacturing, Sales and Marketing Distribution, Administration	Global Generics
Davie, Florida	Manufacturing, Administration	Global Generics/Global Brands
Groveport, Ohio	Distribution, Administration	Distribution
Liverpool, United Kingdom	Administration, R&D	Global Brands
London, United Kingdom	Sales and Marketing, Administration	Global Generics
Lyon, France	Sales and Marketing, Administration	Global Generics
Mississauga, Canada	Distribution, Administration	Global Generics
Morristown, New Jersey	Sales and Marketing, Administration	Global Generics/Global Brands
Mumbai, India	Administration, R&D	Global Generics
Parsippany, New Jersey	Sales and Marketing, Administration	Global Generics/Global Brands
Stevenage, United Kingdom	Sales and Marketing, Administration	Global Generics
Sunrise, Florida	Distribution, Administration	Global Generics
Sydney, Australia	Sales and Marketing, Administration	Global Generics
Weston, Florida	R&D, Administration	Global Generics
Weston, Florida	Distribution, Sales and Marketing, Administration	Distribution

Our leased properties are subject to various lease terms and expirations.

We believe that we have sufficient facilities to conduct our operations during 2011. However, we continue to evaluate the purchase or lease of additional properties, or the consolidation of existing properties as our business requires.

ITEM 3. LEGAL PROCEEDINGS

For information regarding legal proceedings, refer to *Legal Matters* in "NOTE 16 — Commitments and Contingencies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

ITEM 4. REMOVED AND RESERVED

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Registrant's Common Equity

Our common stock is traded on the New York Stock Exchange under the symbol "WPI." The following table sets forth the quarterly high and low share trading price information for the periods indicated:

	High	Low
Year ended December 31, 2010:		
First	\$ 42.50	\$ 37.26
Second	\$ 44.97	\$ 40.50
Third	\$ 45.15	\$ 39.34
Fourth	\$ 52.20	\$ 42.17
Year ended December 31, 2009:		
First	\$ 32.95	\$ 23.05
Second	\$ 33.97	\$ 28.06
Third	\$ 37.20	\$ 32.61
Fourth	\$ 40.25	\$ 33.88

As of February 8, 2011, there were approximately 2,700 registered holders of our common stock.

We have not paid any cash dividends since our initial public offering in February 1993, and do not anticipate paying any cash dividends in the foreseeable future.

Issuer Purchases of Equity Securities

During the quarter ended December 31, 2010, we repurchased 11,441 shares of our common stock surrendered to the Company to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
October 1 - 31, 2010	—	\$ —	—	—
November 1 - 30, 2010	4,948	\$ 49.10	—	—
December 1 - 31, 2010	6,493	\$ 51.31	—	—

Recent Sale of Unregistered Securities; Uses of Proceeds from Registered Securities

None.

Securities Authorized for Issuance Under Equity Compensation Plans

For information regarding securities authorized for issuance under equity compensation plans, refer to "ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS" and "NOTE 12 — Stockholders' Equity" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

[Table of Contents](#)

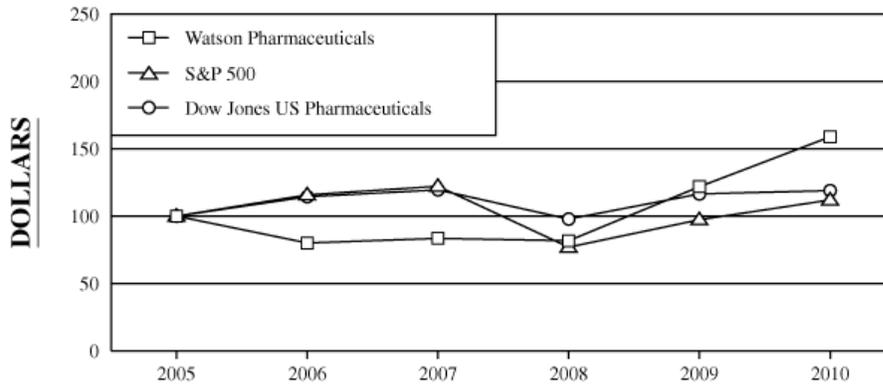
Performance Graph

The information in this section of the Annual Report pertaining to our performance relative to our peers is being furnished but not filed with the SEC, and as such, the information is neither subject to Regulation 14A or 14C or to the liabilities of Section 18 of the Securities Exchange Act of 1934.

The following graph compares the cumulative 5-year total return of holders of Watson's common stock with the cumulative total returns of the S&P 500 index and the Dow Jones US Pharmaceuticals index. The graph tracks the performance of a \$100 investment in our common stock and in each of the indexes (with reinvestment of all dividends, if any) on December 31, 2005 with relative performance tracked through December 31, 2010.

Notwithstanding anything to the contrary set forth in our previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, which might incorporate future filings made by us under those statutes, the following graph will not be deemed incorporated by reference into any future filings made by us under those statutes.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Watson Pharmaceuticals, The S&P 500 Index
And The Dow Jones US Pharmaceuticals Index



* \$100 invested on December 31, 2005 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

Copyright© 2010 S&P, a division of The McGraw-Hill Companies Inc. All rights reserved. Copyright© 2010 Dow Jones & Co. All rights reserved.

	12/05	12/06	12/07	12/08	12/09	12/10
Watson Pharmaceuticals	100.00	80.07	83.48	81.73	121.84	158.87
S&P 500	100.00	115.80	122.16	76.96	97.33	111.99
Dow Jones US Pharmaceuticals	100.00	114.39	119.50	97.81	116.48	118.96

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

ITEM 6. *SELECTED FINANCIAL DATA*

**WATSON
PHARMACEUTICALS, INC.
FINANCIAL HIGHLIGHTS(1)
(In millions, except per share amounts)**

	Years Ended December 31,				
	2010	2009 ⁽²⁾	2008	2007	2006 ⁽³⁾
Operating Highlights:					
Net revenues	\$ 3,566.9	\$ 2,793.0	\$ 2,535.5	\$ 2,496.7	\$ 1,979.2
Operating income (loss)(1)	\$ 305.4	\$ 383.9	\$ 358.2	\$ 255.7	\$ (422.1)
Net income (loss)(1) attributable to common shareholders	\$ 184.4	\$ 222.0	\$ 238.4	\$ 141.0	\$ (445.0)
Basic earnings (loss) per share	\$ 1.51	\$ 2.11	\$ 2.32	\$ 1.38	\$ (4.37)
Diluted earnings (loss) per share	\$ 1.48	\$ 1.96	\$ 2.09	\$ 1.27	\$ (4.37)
Weighted average shares outstanding:					
Basic	122.4	105.0	102.8	102.3	101.8
Diluted	124.2	116.4	117.7	117.0	101.8

	At December 31,				
	2010	2009 ⁽²⁾	2008	2007	2006 ⁽³⁾
Balance Sheet Highlights:					
Current assets	\$ 1,799.4	\$ 1,769.5	\$ 1,458.4	\$ 1,173.8	\$ 1,261.7
Working capital	\$ 978.7	\$ 721.6	\$ 976.4	\$ 728.8	\$ 571.7
Total assets	\$ 5,827.3	\$ 5,903.5	\$ 3,677.9	\$ 3,472.0	\$ 3,760.6
Total debt	\$ 1,016.1	\$ 1,457.8	\$ 877.9	\$ 905.6	\$ 1,231.2
Total equity	\$ 3,282.6	\$ 3,023.1	\$ 2,108.6	\$ 1,849.5	\$ 1,680.4

- (1) For discussion on comparability of operating income and net income, please refer to financial line item discussion in our "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report.
- (2) On December 2, 2009, the Company acquired all the outstanding equity of the Arrow Group in exchange for cash consideration of \$1.05 billion, approximately 16.9 million shares of Restricted Common Stock of Watson, 200,000 shares of Mandatorily Redeemable Preferred Stock of Watson and certain contingent consideration. The fair value of the total consideration was approximately \$1.95 billion. Certain balance sheet amounts were revised in accordance with the completion of our purchase accounting. Refer to NOTE 4 — Acquisitions and Divestitures" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.
- (3) On November 3, 2006, the Company acquired all the outstanding shares of common stock of Andrx Corporation in an all-cash transaction for \$25 per share, or total consideration of approximately \$1.9 billion.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for the historical information contained herein, the following discussion contains forward-looking statements that are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those expressed or implied by such forward-looking statements. We discuss such risks, uncertainties and other factors throughout this report and specifically under the caption "Cautionary Note Regarding Forward-Looking Statements" under "ITEM 1A. RISK FACTORS" in this annual report on Form 10-K ("Annual Report"). In addition, the following discussion of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report.

EXECUTIVE SUMMARY

Overview of Watson

Watson Pharmaceuticals, Inc. ("Watson", the "Company", "we", "us" or "our") was incorporated in 1985 and is engaged in the development, manufacturing, marketing, sale and distribution of brand and generic pharmaceutical products. Watson operates manufacturing, distribution, research and development ("R&D"), and administrative facilities in the United States of America ("U.S.") and, beginning in 2009, in key international markets including Western Europe, Canada, Australasia, South America and South Africa.

As of December 31, 2010, we marketed approximately 160 generic pharmaceutical product families and approximately 30 brand pharmaceutical product families in the U.S. and a significant number of product families internationally through our Global Generics and Global Brands Divisions and distributed approximately 8,500 stock-keeping units ("SKUs") through our Distribution business (also known as "Anda") in the U.S. 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. Our Distribution business primarily distributes generic pharmaceutical products to independent pharmacies, alternate care providers (hospitals, nursing homes and mail order pharmacies) and pharmacy chains, and generic products and certain selective brand products to physicians' offices.

Acquisition of Arrow Group

On December 2, 2009, Watson completed its acquisition of all the outstanding equity of Robin Hood Holdings Limited, a Malta private limited liability company, and Cobalt Laboratories, Inc., a Delaware corporation (together the "Arrow Group") for cash, stock and certain contingent consideration (the "Arrow Acquisition"). In accordance with the terms of the share purchase agreement dated June 16, 2009, as amended on November 26, 2009 (together the "Acquisition Agreement"), the Company acquired all the outstanding equity of the Arrow Group for the following consideration:

- The payment of cash and the assumption of certain liabilities totaling \$1.05 billion;
- Approximately 16.9 million restricted shares of Common Stock of Watson (the "Restricted Common Stock");
- 200,000 shares of newly designated mandatorily redeemable, non-voting Series A Preferred Stock of Watson (the "Mandatorily Redeemable Preferred Stock") placed in an indemnity escrow account for the benefit of the former shareholders of the Arrow Group (the "Arrow Selling Shareholders");
- The Arrow Selling Shareholders will be entitled to the proceeds of the Mandatorily Redeemable Preferred Stock in 2012, less the amount of any indemnity payments; and
- Certain contingent consideration based on the after-tax gross profits on sales of the authorized generic version of Lipitor[®] (atorvastatin) in the U.S. calculated and payable as described in the Acquisition Agreement.

[Table of Contents](#)

As a result of the Arrow Acquisition, Watson also acquired a 36% ownership interest in Eden Biopharm Group Limited ("Eden"), a company which provides development and manufacturing services for early-stage biotech companies, which will provide a long-term foundation for generic biologics. In January 2010, we purchased the remaining interest in Eden for \$15.0 million. Eden results are included in our Global Brands division and will maintain its established contract services model, while providing the Company with biopharmaceutical development and manufacturing capabilities.

2010 Financial Highlights

Among the significant consolidated financial highlights for 2010 were the following:

- Net revenues grew to \$3,566.9 million from \$2,793.0 million in 2009, an increase of \$773.9 million or 28%;
- R&D investment increased \$98.8 million or 50% to \$296.1 million from \$197.3 million in 2009;
- Operating income decreased by \$78.5 million or 20% to \$305.4 million from \$383.9 million in 2009; and
- Net income for 2010 was \$184.4 million (\$1.48 per diluted share) compared to \$222.0 million (\$1.96 per diluted share) in 2009.

Segments

Watson has three reportable segments: Global Generics, Global Brands and Distribution. The Global Generics segment includes off-patent pharmaceutical products that are therapeutically equivalent to proprietary products. The Global Brands segment includes patent-protected products and certain trademarked off-patent products that Watson sells and markets as brand pharmaceutical products. 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 Andra 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 products developed, acquired, or licensed by Watson's Global Generics and Global Brands segments. Our international operating results are included in the Global Generics segment subsequent to the Arrow Acquisition except for operating results from Eden which are included in the Global Brands segment.

The Company evaluates segment performance based on segment net revenues, gross profit and contribution. Segment contribution represents segment net revenues less cost of sales (excludes amortization), direct R&D expenses and selling and marketing expenses. The Company does not report total assets, capital expenditures, corporate general and administrative expenses, amortization, gains on disposal or impairment losses by segment as such information has not been used by management, or has not been accounted for at the segment level.

Global Supply Chain Initiative

During the first quarter of 2008, we announced steps to improve our operating cost structure and achieve operating efficiencies through our Global Supply Chain Initiative ("GSCI"). These 2008 GSCI's included the planned closure of manufacturing facilities in Carmel, New York, our distribution center in Brewster, New York and the transition of manufacturing to our other manufacturing locations within the U.S. and India. Distribution activities at our distribution center in Brewster, New York ceased in July 2009. Product manufacturing ceased in Carmel, New York by December 31, 2010 and we expect a closure of the facility by early 2011. During the second quarter of 2010, the Company announced additional measures to reduce its cost structure involving a manufacturing facility in Canada, certain R&D activities in Canada and certain R&D activities in Australia. In January 2011, the Company announced the closure of R&D activities in Corona, California. These additional restructuring activities, and the transfer of development activities to existing R&D sites, are expected to be completed in Australia by early 2011, in Corona by the end of 2011 and in Canada by late 2012. The Company expects to incur additional pre-tax costs associated with the

Table of Contents

planned closures during 2011 and 2012 of approximately \$20.0 to \$25.0 million which includes accelerated depreciation expense of \$7.0 to \$8.5 million, severance, retention, relocation and other employee related costs of approximately \$5.0 to \$8.0 million and product transfer costs of approximately \$8.0 to \$8.5 million.

YEAR ENDED DECEMBER 31, 2010 COMPARED TO 2009

Results of operations, including segment net revenues, segment operating expenses and segment contribution information for the Company's Global Generics, Global Brands and Distribution segments, consisted of the following (in millions):

	Years Ended December 31,							
	2010				2009			
	Global Generics	Global Brands	Distribution	Total	Global Generics	Global Brands	Distribution	Total
Product sales	\$ 2,268.9	\$ 316.3	\$ 830.7	\$ 3,415.9	\$ 1,641.8	\$ 393.7	\$ 663.8	\$ 2,699.3
Other revenue	69.5	81.5	—	151.0	26.4	67.3	—	93.7
Net revenues	2,338.4	397.8	830.7	3,566.9	1,668.2	461.0	663.8	2,793.0
Operating expenses:								
Cost of sales(1)	1,198.9	88.4	711.2	1,998.5	947.1	89.3	560.4	1,596.8
Research and development	194.6	101.5	—	296.1	140.4	56.9	—	197.3
Selling and marketing	111.9	137.8	70.3	320.0	53.8	144.5	64.8	263.1
Contribution	\$ 833.0	\$ 70.1	\$ 49.2	952.3	\$ 526.9	\$ 170.3	\$ 38.6	735.8
Contribution margin	35.6%	17.6%	5.9%	26.7%	31.6%	36.9%	5.8%	26.3%
General and administrative				436.1				257.1
Amortization				180.0				92.6
Loss on asset sales and impairments				30.8				2.2
Operating income				\$ 305.4				\$ 383.9
Operating margin				8.6%				13.7%

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

Global Generics Segment

Net Revenues

Our Global Generics 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, or if we are successful in developing a bioequivalent, non-infringing version of 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 Global Generics segment include product sales and other revenue. Our Global Generics 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, inhalation products and transmucosals.

Other revenues consist primarily of royalties, milestone receipts and commission revenue.

Net revenues from our Global Generics segment during the year ended December 31, 2010 increased 40.2% or \$670.2 million to \$2,338.4 million compared to net revenues of \$1,668.2 million from the prior year. The increase in net revenues was mainly attributable to increased international revenues due to the Arrow

Table of Contents

Acquisition in 2009 (\$367.8 million), higher sales of extended release products (\$225.3 million) and an increase in other revenue (\$43.1 million).

The 2010 increase in other revenue (\$43.1 million) primarily related to milestone receipts (\$27.5 million) and other revenues from the Arrow Group.

Cost of Sales

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

Cost of sales for our Global Generics segment increased 26.6% or \$251.8 million to \$1,198.9 million in the year ended December 31, 2010 compared to \$947.1 million in the prior year. This increase in cost of sales was mainly attributable to the inclusion of Arrow Group during the period (\$242.5 million) and higher sales of extended release products (\$13.5 million). The increase in cost of sales was partially offset by cost savings from the implementation of our GSCI.

Research and Development Expenses

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

R&D expenses within our Global Generics segment increased 38.6% or \$54.2 million to \$194.6 million for the year ended December 31, 2010 compared to \$140.4 million from the prior year. This increase in R&D expenses was due primarily to the inclusion of Arrow Group (\$51.2 million).

Selling and Marketing Expenses

Selling and marketing expenses consist mainly of personnel-related costs, distribution costs, professional services costs, insurance, depreciation and travel costs.

Selling and marketing expenses increased 108.1% or \$58.1 million to \$111.9 million for the year ended December 31, 2010 compared to \$53.8 million from the prior year due primarily to the inclusion of Arrow Group selling and marketing expenses in the current period (\$61.1 million) which was partially offset by cost savings as a result of the implementation of our Global Supply Chain Initiative.

Global Brands Segment

Net Revenues

Our Global Brands segment includes our promoted products such as Rapaflo[®], Gelnique[®], Crinone[®], Trelstar[®], ella[®] and INFeD[®] and a number of non-promoted products.

Other revenues in the Global Brands 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 Global Brands segment for the year ended December 31, 2010 decreased 13.7% or \$63.2 million to \$397.8 million compared to net revenues of \$461.0 million from the prior year. The decrease in net revenues was primarily attributable to the loss of Ferrlecit[®] (\$113.8 million), as our distribution rights for Ferrlecit[®] terminated on December 31, 2009. The decline in revenues from the loss of Ferrlecit[®] was partially offset by sales of new products, including Rapaflo[®], Gelnique[®] and Crinone[®], higher sales of INFeD[®] (as sales during 2009 were negatively impacted by a supply interruption) and higher sales of Androderm[®]. Combined these products resulted in an increase in product sales of \$55.2 million. Other revenues also increased by \$14.2 million.

Table of Contents

The increase in other revenue was primarily due to the out-licensing of a number of legacy brand products including Monodox[®] and certain forms of Cordran[®] (\$8.0 million), higher co-promotion revenues (\$2.8 million) and an increase in international other revenues related to our acquisition of Eden.

Cost of Sales

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

Cost of sales for our Global Brands segment decreased 0.9% or \$0.9 million to \$88.4 million in the year ended December 31, 2010 compared to \$89.3 million in the prior year. This decrease in cost of sales was attributable to the loss in sales of Ferrlecit[®] offset by increases in cost of sales due to new products and overall product mix.

Research and Development Expenses

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

R&D expenses within our Global Brands segment increased 78.3% or \$44.6 million to \$101.5 million compared to \$56.9 million from the prior year primarily due to an increase in milestone payments in the current year (\$22.8 million), a fair value adjustment related to a product in development acquired from Columbia Laboratories, Inc. ("Columbia") (\$7.7 million), the inclusion of R&D expenditures from recently acquired Eden (\$6.8 million) and higher clinical spending.

Selling and Marketing Expenses

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

Selling and marketing expenses within our Global Brands segment decreased 4.6% or \$6.7 million to \$137.8 million compared to \$144.5 million from the prior year primarily due to lower field force, marketing and support costs (\$5.4 million) and lower promotional costs (\$2.0 million) due mainly to the loss of Ferrlecit[®].

Distribution Segment

Net Revenues

Our Distribution business distributes generic and certain select brand 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 sales by Anda of products developed, acquired, or licensed by Watson's Global Generics and Global Brands segments.

Net revenues from our Distribution segment for the year ended December 31, 2010 increased 25.1% or \$166.9 million to \$830.7 million compared to net revenues of \$663.8 million in the prior year primarily due to an increase in net revenues from new product launches (\$175.9 million) and higher third party brand product sales (\$14.1 million) which were partially offset by a decline in the base business (\$23.1 million).

Cost of Sales

Cost of sales for our Distribution segment includes third party acquisition costs for products manufactured by others, profit-sharing or royalty payments for products sold pursuant to licensing agreements and inventory

[Table of Contents](#)

reserve charges, where applicable. Cost of sales does not include amortization costs for acquired product rights or other acquired intangibles.

Cost of sales for our Distribution segment increased 26.9% or \$150.8 million to \$711.2 million in the year ended December 31, 2010 compared to \$560.4 million in the prior year due to higher product sales.

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 8.3% or \$5.5 million to \$70.3 million in the year ended December 31, 2010 as compared to \$64.8 million in the prior year primarily due to higher variable costs related to increased sales.

Corporate General and Administrative Expenses

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
Corporate general and administrative expenses	\$ 436.1	\$ 257.1	\$ 179.0	69.6%
as % of net revenues	12.2%	9.2%		

Corporate general and administrative expenses consist mainly of personnel-related costs, facilities costs, insurance, depreciation, litigation and settlement costs and professional services costs which are general in nature and not directly related to specific segment operations.

Corporate general and administrative expenses increased 69.6% or \$179.0 million to \$436.1 million compared to \$257.1 million from the prior year due to an increase in accrued legal contingencies and legal costs over the prior year period (\$123.0 million), inclusion of Arrow administrative expenses for the period (\$50.9 million) and higher Anda bad debt expense (\$4.3 million).

Amortization

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
Amortization	\$ 180.0	\$ 92.6	\$ 87.4	94.4%
as % of net revenues	5.0%	3.3%		

The Company's amortizable assets consist primarily of acquired product rights. Amortization in 2010 increased primarily as a result of the amortization of product rights the Company acquired in the Arrow Acquisition.

Loss on Asset Sales and Impairments

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
Loss on asset sales and impairments	\$ 30.8	\$ 2.2	\$ 28.6	1300.0%

Due to changes in market conditions in certain international locations, the Company performed an off-cycle impairment review in the fourth quarter of 2010. As a result of this review, the Company recorded an impairment charge for certain acquired in-process research and development ("IPR&D") intangibles acquired in the Arrow Acquisition of \$28.6 million. Additionally, we recognized a loss on the sale of stock in our Sweden subsidiary during the year ended December 31, 2010.

Table of Contents

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. In September 2009, we recognized a \$3.5 million impairment on an API manufacturing facility in China.

Interest Income

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
	(\$ in millions):			
Interest income	\$ 1.6	\$ 5.0	\$ (3.4)	(68.0)%

Interest income decreased during the year ended December 31, 2010 primarily due to the decrease in interest rates and invested balances over the prior year period.

Interest Expense

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
	(\$ in millions):			
Interest expense — \$850.0 million Senior Notes due 2014 (the "2014 Notes") and due 2019 (the "2019 Notes"), together the "Senior Notes"	\$ 48.8	\$ 17.5	\$ 31.3	
Interest expense — Preferred accretion	15.2	1.2	14.0	
Interest expense — Atorvastatin accretion	12.1	1.0	11.1	
Interest expense — Columbia accretion	3.3	—	3.3	
Interest expense — Senior Credit Facility with Canadian Imperial Bank of Commerce, Wachovia Capital Markets, LLC and a syndicate of banks ("2006 Credit Facility"), due 2011	3.7	4.9	(1.2)	
Interest expense — Convertible contingent senior debentures ("CODES")	—	8.9	(8.9)	
Interest expense — other	1.0	0.7	0.3	
Interest expense	\$ 84.1	\$ 34.2	\$ 49.9	145.9%

Interest expense increased for the year ended December 31, 2010 over the prior year primarily due to interest on the Senior Notes issued in 2009, interest accretion charges on the Mandatorily Redeemable Preferred Stock issued in the Arrow Acquisition, accretion of interest on the atorvastatin contingent consideration obligation and accretion of interest on the Columbia contingent consideration obligation, which was partially offset by interest on the CODES which were redeemed during 2009.

Other Income

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
	(\$ in millions):			
Gain (loss) on sale of securities	\$ 25.6	\$ (1.1)	\$ 26.7	
Earnings on equity method investments	1.6	10.8	(9.2)	
Loss on early extinguishment of debt	(0.5)	(2.0)	1.5	
Other income	1.0	0.2	0.8	
	\$ 27.7	\$ 7.9	\$ 19.8	250.6%

[Table of Contents](#)

Gain (loss) on Sale of Securities

During 2010, we completed the sale of our outstanding shares of Scinopharm Taiwan Ltd. ("Scinopharm") for net proceeds of approximately \$94.0 million and recorded a gain of \$23.3 million.

In the year ended December 31, 2009, the Company recorded an other-than-temporary impairment charge of \$2.2 million related to our investment in common shares of inVentiv Health, Inc. as the fair value of our investment fell below our carrying value. This loss was partially offset by the receipt of cash proceeds of \$1.1 million as additional consideration on the sale of our investment in Adheris, Inc.

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.

The earnings on equity investments for the year ended December 31, 2009 were higher than the current year due to the sale of our outstanding shares of Scinopharm during the first quarter of 2010.

Loss on Early Extinguishment of Debt

In November 2006, we entered into the 2006 Credit Facility in connection with the acquisition of Andrx Corporation ("Andrx") on November 3, 2006 (the "Andrx Acquisition"). The 2006 Credit Facility provides an aggregate of \$1.15 billion of senior financing to Watson, consisting of a \$500.0 million revolving credit facility ("Revolving Facility") and a \$650.0 million senior term loan facility ("Term Facility") and is due to expire in November 2011.

For the year ended December 31, 2010, we recognized a \$0.5 million loss on early extinguishment of debt due to the early repayment of the remaining amount owing under the Term Facility of the 2006 Credit Facility.

On July 1, 2009, the Company entered into an amendment to the 2006 Credit Facility. The terms of the amendment included the repayment of \$100.0 million on the Term Facility under the 2006 Credit Agreement not later than December 16, 2009. As a result of the \$100.0 million repayment in 2009 under the Term Facility, the Company's 2009 results reflect a \$0.8 million charge for a loss on the early extinguishment of debt in respect of the 2006 Credit Facility.

On September 14, 2009, the CODES were redeemed in accordance with the terms of the CODES. As a result of the redemption of the CODES, the Company's results for 2009 reflect a \$1.2 million loss on the early extinguishment of the CODES.

Provision for Income Taxes

	Years Ended December 31,		Change	
	2010	2009	Dollars	%
Provision for income taxes	\$ 67.3	\$ 140.6	\$ (73.3)	(52.1)%
Effective tax rate	26.9%	38.8%		

The lower effective tax rate for the year ended December 31, 2010 compared to the prior year, is primarily due to non-recurring tax benefits associated with the closure of the IRS audit for the 2004-2006 tax years, reduction in the statutory tax rates in foreign jurisdictions, tax benefits associated with the Arrow Acquisition and the disposition and write-off of foreign subsidiaries.

[Table of Contents](#)

YEAR ENDED DECEMBER 31, 2009 COMPARED TO 2008

Results of operations, including segment net revenues, segment operating expenses and segment contribution information for the Company's Global Generics, Global Brands and Distribution segments, consisted of the following (in millions):

	2009				2008			
	Global Generics	Global Brands	Distribution	Total	Global Generics	Global Brands	Distribution	Total
Product sales	\$ 1,641.8	\$ 393.7	\$ 663.8	\$ 2,699.3	\$ 1,404.0	\$ 397.0	\$ 606.2	\$ 2,407.2
Other revenue	26.4	67.3	—	93.7	70.3	58.0	—	128.3
Net revenues	1,668.2	461.0	663.8	2,793.0	1,474.3	455.0	606.2	2,535.5
Operating expenses:								
Cost of sales(1)	947.1	89.3	560.4	1,596.8	883.8	107.1	511.9	1,502.8
Research and development	140.4	56.9	—	197.3	119.2	50.9	—	170.1
Selling and marketing	53.8	144.5	64.8	263.1	55.2	118.2	59.5	232.9
Contribution	\$ 526.9	\$ 170.3	\$ 38.6	735.8	\$ 416.1	\$ 178.8	\$ 34.8	629.7
Contribution margin	31.6%	36.9%	5.8%	26.3%	28.2%	39.3%	5.7%	24.8%
General and administrative				257.1				190.5
Amortization				92.6				80.7
Loss on asset sales and impairments				2.2				0.3
Operating income				\$ 383.9				\$ 358.2
Operating margin				13.7%				14.1%

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

Global Generics Segment

Net Revenues

Net revenues from our Global Generics segment during the year ended December 31, 2009 increased 13.2% or \$193.9 million to \$1,668.2 million compared to net revenues of \$1,474.3 million from the prior year.

The increase in net revenues was mainly attributable to new product launches in 2009 and in late 2008 (\$244.9 million) as well as revenue from the inclusion of Arrow Group results for the month of December (\$46.4 million) offset in part by a decrease in other revenue (\$43.9 million) and a decrease in sales of alendronate sodium tablets and omeprazole due to increased competition (\$66.9 million).

Of the \$43.9 million decrease in other revenue, there was a \$20.2 million decline in royalties on sales by Sandoz, Inc. of metoprolol succinate 50 mg extended release tablets and reduced royalties on sales by GlaxoSmithKline of Wellbutrin XL[®] 150 mg. Sales of metoprolol succinate 50 mg declined as Sandoz, Inc. ceased shipping the product in the fourth quarter of 2008. Sales of Wellbutrin XL[®] 150 mg declined due to increased competition. Other revenue also declined as the prior year period included a \$15.0 million milestone payment.

Cost of Sales

Cost of sales for our Global Generics segment increased 7.2% or \$63.3 million to \$947.1 million in the year ended December 31, 2009 compared to \$883.8 million in the prior year. This increase in cost of sales was mainly attributable to the inclusion of Arrow Group results for the month of December (\$43.5 million) and higher product sales in the current year partially offset by manufacturing efficiencies as a result of the implementation of our Global Supply Chain Initiative. Arrow Group's cost of sales for the month of December include \$14.2 million of additional inventory costs associated with the fair value step-up in acquired inventory.

[Table of Contents](#)

Research and Development Expenses

R&D expenses within our Global Generics segment increased 17.8% or \$21.2 million to \$140.4 million for the year ended December 31, 2009 compared to \$119.2 million from the prior year. This increase in R&D expenses was mainly due to higher test chemical and biostudy costs (\$14.8 million) and increased international R&D expenditures (\$11.4 million), (including those of the recently acquired Arrow Group), partially offset by lower consulting costs (\$3.5 million).

Selling and Marketing Expenses

Global Generics selling and marketing expenses decreased 2.5% or \$1.4 million to \$53.8 million for the year ended December 31, 2009 compared to \$55.2 million from the prior year due primarily to cost savings as a result of the implementation of our GSCI.

Global Brands Segment

Net Revenues

Net revenues from our Global Brands segment for the year ended December 31, 2009 increased 1.3% or \$6.0 million to \$461.0 million compared to net revenues of \$455.0 million from the prior year. The increase in net revenues was primarily attributable to higher other revenues (\$9.3 million) which was partially offset by lower net product sales (\$3.3 million).

The increase in other revenue was primarily due to increased revenues from the Company's promotion of AndroGel[®] and Femring[®] which was partially offset by a decrease in the amount of deferred revenues recognized in 2009.

During 2009, the Global Brands segment launched Rapaflo[®] and Gelnique[®] and experienced higher sales of certain non-promoted products in the year. The increase in sales from product launches and sales of certain non-promoted products was offset by declines in sales of both INFeD[®] and Ferrlecit[®] during 2009. Lower sales of INFeD[®] resulted from a supply interruption of INFeD[®]'s API which is available from only one source. We resumed shipments of INFeD[®] in July 2009. Lower sales of Ferrlecit[®] primarily resulted from a customer transitioning to a competing product during the current year period. Our distribution rights for Ferrlecit[®] terminated on December 31, 2009.

Cost of Sales

Cost of sales for our Global Brands segment decreased 16.6% or \$17.8 million to \$89.3 million in the year ended December 31, 2009 compared to \$107.1 million in the prior year. This decrease in cost of sales was attributable to a \$7.7 million inventory reserve charge to cost of sales in 2008 related to our INFeD[®] product, lower product sales in 2009 and lower unit manufacturing costs for products we manufacture due to higher manufacturing volumes at certain manufacturing sites.

Research and Development Expenses

R&D expenses within our Global Brands segment increased 11.8% or \$6.0 million to \$56.9 million in the year ended December 31, 2009 compared to \$50.9 million from the prior year primarily due to a higher clinical spending (\$4.4 million) and higher labor costs (\$2.7 million) which were partially offset by lower milestone payments in 2009.

Selling and Marketing Expenses

Selling and marketing expenses within our Global Brands segment increased 22.3% or \$26.3 million to \$144.5 million in the year ended December 31, 2009 compared to \$118.2 million from the prior year primarily due to higher expenditures in 2009 to support launch activities related to Rapaflo[®] and Gelnique[®].

[Table of Contents](#)

Distribution Segment

Net Revenues

Net revenues from our Distribution segment for the year ended December 31, 2009 increased 9.5% or \$57.6 million to \$663.8 million compared to net revenues of \$606.2 million in the prior year primarily due to an increase in net revenues from new products launched in late 2008 and in 2009 (\$166.6 million) which was partially offset by lower levels of sales in the current year from prior period product launches and declines in the base business (\$108.9 million).

Cost of Sales

Cost of sales for our Distribution segment increased 9.5% or \$48.5 million to \$560.4 million in the year ended December 31, 2009 compared to \$511.9 million in the prior year due to higher product sales.

Selling and Marketing Expenses

Distribution segment selling and marketing expenses increased 8.9% or \$5.3 million to \$64.8 million in the year ended December 31, 2009 as compared to \$59.5 million in the prior year primarily due to an increase in payroll costs (\$5.0 million).

Corporate General and Administrative Expenses

	Years Ended December 31,		Change	
	2009	2008	Dollars	%
Corporate general and administrative expenses	\$ 257.1	\$ 190.5	\$ 66.6	35.0%
<i>as % of net revenues</i>	<i>9.2%</i>	<i>7.5%</i>		

Corporate general and administrative expenses increased 35.0% or \$66.6 million to \$257.1 million in the year ended December 31, 2009 compared to \$190.5 million from the prior year due to an increase in legal settlements (\$24.7 million), acquisition and integration costs (\$16.6 million), higher litigation and legal costs (\$13.5 million) and as well as general and administrative costs from the inclusion of Arrow Group results for the month of December (\$6.2 million). In addition, 2008 was favorably impacted by the settlement of a tax-related liability (\$5.9 million) as a result of the resolution of the Internal Revenue Service ("IRS") federal income tax return examination.

Amortization

	Years Ended December 31,		Change	
	2009	2008	Dollars	%
Amortization	\$ 92.6	\$ 80.7	\$ 11.9	14.7%
<i>as % of net revenues</i>	<i>3.3%</i>	<i>3.2%</i>		

The Company's amortizable assets consist primarily of acquired product rights. Amortization in 2009 increased primarily as a result of the amortization of product rights the Company acquired in the fourth quarter of 2008 as a result of the merger between Teva Pharmaceutical Industries, Ltd. ("Teva") and Barr Pharmaceuticals, Inc. ("Barr") and from one month of amortization expense related to currently marketed product intangibles acquired in the Arrow Acquisition.

Interest Income

	Years Ended December 31,		Change	
	2009	2008	Dollars	%
Interest income	\$ 5.0	\$ 9.0	\$ (4.0)	(44.4)%

[Table of Contents](#)

Interest income decreased during the year ended December 31, 2009 primarily due to the decrease in interest rates over the prior year period.

Interest Expense

	Years Ended December 31,		Change	
	2009	2008	Dollars	%
	(\$ in millions):			
Interest expense — Senior Notes	\$ 17.5	\$ —	\$ 17.5	
Interest expense — CODES	8.9	12.6	(3.7)	
Interest expense — 2006 Credit Facility due 2011	4.9	15.4	(10.5)	
Interest expense — Preferred accretion	1.2	—	1.2	
Interest expense — Atorvastatin accretion	1.0	—	1.0	
Interest expense — other	0.7	0.2	0.5	
Interest expense	\$ 34.2	\$ 28.2	\$ 6.0	21.1%

Interest expense increased for the year ended December 31, 2009 over the prior year primarily due to interest on the Senior Notes issued during the year and interest accretion charges on the Preferred Shares issued in the Arrow Acquisition and accretion of interest on the atorvastatin obligation which was partially offset by reduced interest on the CODES which were redeemed during the year and due to reduced LIBOR rates of interest on the 2006 Credit Facility.

Other Income

	Years Ended December 31,		Change	
	2009	2008	Dollars	%
	(\$ in millions):			
Earnings on equity method investments	\$ 10.8	\$ 10.6	\$ 0.2	
(Loss) gain on sale of securities	(1.1)	9.6	(10.7)	
Loss on early extinguishment of debt	(2.0)	(1.1)	(0.9)	
Other income	0.2	0.2	—	
	\$ 7.9	\$ 19.3	\$ (11.4)	(59.1)%

Earnings on Equity Method Investments

The earnings on equity investments for the year ended December 31, 2009 and 2008 primarily represent our share of equity earnings in Scinopharm. As discussed in "NOTE 4 — Acquisitions and Divestitures" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report, the Company sold its shares in Scinopharm in 2010.

(Loss) Gain on Sale of Securities

The 2008 gain on sale of securities primarily related to the Company's sale of our fifty percent interest in Somerset Pharmaceuticals, Inc. ("Somerset"), our joint venture with Mylan Inc.

Loss on Early Extinguishment of Debt

On July 1, 2009, the Company entered into an amendment to the 2006 Credit Facility. The terms of the amendment included the repayment of \$100.0 million on the term facility under the 2006 Credit Agreement not later than December 16, 2009. As a result of the \$100.0 million repayment in 2009 under the term facility, the Company's results reflect a \$0.8 million charge for losses on the early extinguishment of debt in respect of the 2006 Credit Facility.

[Table of Contents](#)

Cash Flows from Operations

Summarized cash flow from operations is as follows:

	Years Ended December 31,		
	2010	2009	2008
		(\$ in millions):	
Net cash provided by operating activities	\$ 571.0	\$ 376.8	\$ 416.6

Cash flows from operations represents net income adjusted for certain non-cash items and changes in assets and liabilities. The Company has generated cash flows from operating activities primarily driven by net income adjusted for amortization of our acquired product rights and depreciation. Cash provided by operating activities was \$571.0 million in 2010, compared to \$376.8 million in 2009 and \$416.6 million in 2008. Net cash provided by operations was higher in 2010 compared to 2009, as accounts payable and accrued expenses increased in 2010, inventory decreased in 2010, \$55.0 million was collected on an acquisition-related receivable during 2010 and net income adjusted for amortization charges was higher in 2010. Net cash provided by operations was lower in 2009 compared to 2008 primarily due to comparatively higher levels of inventory and accounts receivables partially offset by decreased levels of accounts payable and accrued expenses.

Management expects that available cash balances and 2011 cash flows from operating activities will provide sufficient resources to fund our operating liquidity needs and expected 2011 capital expenditure funding requirements.

Investing Cash Flows

Our cash flows from investing activities are summarized as follows:

	Years Ended December 31,		
	2010	2009	2008
		(\$ in millions):	
Net cash used in investing activities	\$ 74.1	\$ 1,036.1	\$ 93.4

Investing cash flows consist primarily of expenditures related to acquisitions, capital expenditures, investment and marketable security additions, as well as proceeds from investment and marketable security sales. We used \$74.1 million in net cash for investing activities during 2010 compared to \$1,036.1 million in 2009 and \$93.4 million in 2008. Net cash used in investing activities was lower in 2010 compared to 2009 due primarily to the Arrow Acquisition in 2009. Net cash used in investing activities was higher in 2009 compared to 2008 primarily due to the Arrow Acquisition.

Financing Cash Flows

Our cash flows from financing activities are summarized as follows:

	Years Ended December 31,		
	2010	2009	2008
		(\$ in millions):	
Net cash (used in) provided by financing activities	\$ (411.3)	\$ 353.1	\$ (20.2)

Financing cash flows consist primarily of borrowings and repayments of debt, repurchases of common stock and proceeds from exercising of stock options. For 2010, net cash used in financing activities was \$411.3 million compared to \$353.1 million provided by financing activities during 2009 and \$20.2 million used in financing activities during 2008. Cash used in financing activities in 2010 primarily related to the repayment of \$400.0 million on the 2006 Credit Facility. Cash provided by financing activities in 2009 primarily related to net proceeds received from the issue of \$850.0 million under the Senior Notes and net borrowings of \$100.0 million under the 2006 Credit Facility which was partially offset by the redemption of the CODES. During 2008, we prepaid \$75.0 million and borrowed \$50.0 million under our 2006 Credit Facility.

[Table of Contents](#)

Debt and Borrowing Capacity

Our outstanding debt obligations are summarized as follows:

	<u>2010</u>	<u>2009</u>	<u>Increase</u>
		(\$ in millions):	(Decrease)
Short-term debt and current portion of long-term debt	\$ —	\$ 307.6	\$ (307.6)
Long-term debt	1,016.2	1,150.2	(134.0)
Total debt outstanding	<u>\$ 1,016.2</u>	<u>\$ 1,457.8</u>	<u>\$ (441.6)</u>
Debt to capital ratio	23.5%	32.5%	

On August 24, 2009, the Company gave notice to Wells Fargo Bank, National Association, as trustee of the CODES (the "Trustee"), and the Trustee delivered an irrevocable notice of redemption to the holders of the CODES that the Company elected to redeem the CODES for cash at a price equal to 100% of the principal amount of the CODES, plus interest accrued and unpaid to, but excluding, the redemption date. On September 14, 2009 the CODES were redeemed in accordance with the terms of the CODES. As a result of the redemption of the CODES, the Company's results for the year ended December 31, 2009 reflect a \$1.2 million charge for losses on the early extinguishment of debt in respect of the CODES.

In November 2006, we entered into the 2006 Credit Facility. The 2006 Credit Facility provides an aggregate of \$1.15 billion of senior financing to Watson, consisting of a \$500.0 million Revolving Facility and a \$650.0 million Term Facility and an initial interest rate equal to LIBOR plus 0.75% (subject to certain adjustments). In July 2010, the interest rate on the 2006 Credit Facility was reduced to LIBOR plus 0.625%.

The 2006 Credit Facility has a five-year term and matures in November 2011. Indebtedness under the 2006 Credit Facility is guaranteed by Watson's material domestic subsidiaries. The Revolving Facility is available for working capital and other general corporate requirements subject to the satisfaction of certain conditions.

On July 1, 2009, the Company entered into an amendment to the 2006 Credit Facility which, among other things, provided certain modifications and clarifications with respect to refinancing of the Company's outstanding indebtedness, allowed an increase in the Company's ability to incur general unsecured indebtedness from \$100.0 million to \$500.0 million and provides an exclusion from certain restrictions under the 2006 Credit Facility on up to \$151.4 million of certain anticipated acquired indebtedness under the Arrow Acquisition. The terms of the amendment also required the repayment of \$100.0 million on the Term Facility under the 2006 Credit Agreement. As a result of this \$100.0 million repayment, the Company's results for the year ended December 31, 2009 reflect a \$0.8 million charge for losses on the early extinguishment of debt in respect of the 2006 Credit Facility. In addition to the above repayment on the Term Facility of the 2006 Credit Facility, the Company also made a \$75.0 million repayment on the Revolving Facility of the 2006 Credit Facility in the year ended December 31, 2009. The Company borrowed \$275.0 million under the Revolving Facility in 2009 to fund a portion of the cash consideration for the Arrow Acquisition.

During the year ended December 31, 2010, we incurred \$0.5 million charge for losses on the early extinguishment of debt in respect of the 2006 Credit Facility matures in November 2011. As of December 31, 2010, no amounts were outstanding on either the Revolving Facility or the Term Facility of the 2006 Credit Facility.

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 December 31, 2010, 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 \$1.7 billion;
- maintenance of a maximum leverage ratio not greater than 2.50 to 1.0; and
- maintenance of a minimum interest coverage ratio of at least 5.0 to 1.0.

Table of Contents

At December 31, 2010, our net worth was \$3.3 billion, and our leverage ratio was 1.01 to 1.0. Our interest coverage ratio for the period ended December 31, 2010 was 15.7 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 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

The following table lists our enforceable and legally binding obligations as of December 31, 2010. Some of the amounts included herein are based on management's estimates and assumptions about these obligations, including their duration, the possibility of renewal, anticipated actions by third parties, and other factors. Because these estimates and assumptions are necessarily subjective, the enforceable and legally binding obligation we will actually pay in future periods may vary from those reflected in the table:

	Payments Due by Period (Including Interest on Debt)				
	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
	(In millions):				
Long-term debt and other debt(1)	\$ 1,345.2	\$ 47.2	\$ 783.2	\$ 50.5	\$ 464.3
Contingent consideration liabilities(2)	264.6	46.5	211.3	6.0	0.8
Operating lease obligations	135.9	24.4	45.7	22.8	43.0
Milestone obligations(3)	48.2	11.0	26.0	11.2	—
Other obligations and commitments(4)	99.8	19.0	14.8	5.4	60.6
Total(5)	\$ 1,893.7	\$ 148.1	\$ 1,081.0	\$ 95.9	\$ 568.7

- (1) Amounts represent total anticipated cash payments and anticipated interest payments, as applicable, on the Senior Notes, the Mandatorily Redeemable Preferred Stock and amounts outstanding on our long term-debt obligations assuming existing debt maturity or redemption schedules. The maturity schedule in the above table in respect of the Mandatorily Redeemable Preferred Stock assumes redemption in cash on December 2, 2012, the third anniversary of issuance, in accordance with the terms of the Share Purchase Agreement. Amounts exclude fair value adjustments, discounts or premiums on outstanding debt obligations.
- (2) Amount represents contingent payment obligations resulting from the Arrow Acquisition and the Columbia acquisition. Arrow Acquisition contingent obligations include amounts due to Arrow Selling Shareholders on the after-tax gross profits on sales of atorvastatin in the U.S. as described in the Acquisition Agreement. Columbia acquisition contingent obligations include amounts due to Columbia primarily related to anticipated future milestone payments and royalty payments. For a more detailed description of the terms of the contingent consideration liabilities, refer to "NOTE 10 — Other Long-Term Liabilities" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.
- (3) We have future potential milestone payments payable to third parties as part of our licensing and development programs. Payments under these agreements generally become due and payable upon the satisfaction or achievement of certain developmental, regulatory or commercial milestones. Amounts represent contractual payment obligations due on achievement of developmental, regulatory or commercial milestones based on anticipated approval dates assuming all milestone approval events are met. Milestone payment obligations are uncertain, including the prediction of timing and the occurrence of events triggering a future

Table of Contents

obligation and are not reflected as liabilities in our consolidated balance sheet. Amounts in the table above do not include royalty obligations on future sales of product as the timing and amount of future sales levels and costs to produce products subject to milestone obligations is not reasonably estimable.

- (4) Other obligations and commitments include agreements to purchase third-party manufactured products, capital purchase obligations for the construction or purchase of property, plant and equipment and the liability for income tax associated with uncertain tax positions.
- (5) Total does not include contractual obligations already included in current liabilities on our Consolidated Balance Sheet (except for short-term debt and the current portion of long-term debt) or certain purchase obligations, which are discussed below.

For purposes of the table above, obligations for the purchase of goods or services are included only for purchase orders that are enforceable, legally binding and specify all significant terms including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the timing of the obligation. Our purchase orders are based on our current manufacturing needs and are typically fulfilled by our suppliers within a relatively short period. At December 31, 2010, we have open purchase orders that represent authorizations to purchase rather than binding agreements that are not included in the table above.

We are involved in certain joint venture arrangements that are intended to complement our core business and markets. We have the discretion to provide funding on occasion for working capital or capital expenditures. We make an evaluation of additional funding based on an assessment of the venture's business opportunities. We believe that any possible commitments arising from the current arrangements will not be significant to our financial condition, results of operations or liquidity.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, net revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting estimates that we believe are important to aid in fully understanding and evaluating our reported financial results include the following:

- Revenue and Provision for Sales Returns and Allowances
- Revenue Recognition
- Inventory Valuation
- Investments
- Product Rights and other Definite-Lived Intangible Assets
- Goodwill and Intangible Assets with Indefinite-Lives
- Allocation of Acquisition Fair Values to Assets Acquired and Liabilities Assumed

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available GAAP alternatives would not produce a materially different result.

Revenue and Provision for Sales Returns and Allowances

As is customary in the pharmaceutical industry, our gross product sales are subject to a variety of deductions in arriving at reported net product sales. When we recognize revenue from the sale of our 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. We use a variety of methods to assess the adequacy of our SRA reserves to ensure that our 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.

Chargebacks — 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. Our chargeback provision and related reserve varies 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. We validate 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 our chargeback payments. We continually monitor current pricing trends and wholesaler inventory levels to ensure the liability for future chargebacks is fairly stated.

Rebates — Rebates include volume related incentives to direct and indirect customers and Medicaid rebates based on claims from Medicaid benefit providers.

Volume rebates are generally offered to customers as an incentive to continue to carry our products and to encourage greater product sales. These rebate programs include contracted rebates based on customers' purchases made during an applicable monthly, quarterly or annual period. The provision for rebates is estimated based on our customers' contracted rebate programs and our historical experience of rebates paid. Any significant changes to our customer rebate programs are considered in establishing our provision for rebates. We continually monitor our customer rebate programs to ensure that the liability for accrued rebates is fairly stated.

The provision for Medicaid rebates is based upon historical experience of claims submitted by the various states. We monitor Medicaid legislative changes to determine what impact such legislation may have on our provision for Medicaid rebates. Our accrual of Medicaid rebates is based on historical payment rates and is reviewed on a quarterly basis against actual claim data to ensure the liability is fairly stated.

Returns and Other Allowances — Our provision for returns and other allowances include returns, pricing adjustments, promotional allowances and billback adjustments.

Consistent with industry practice, we maintain a return policy that allows our customers to return product for credit. In accordance with our return goods policy, credit for customer returns of product is applied against outstanding account activity or by check. Product exchanges are not permitted. Customer returns of product are not resalable unless the return is due to a shipping error. Our estimate of the provision for returns is based upon historical experience and current trends of actual customer returns. Additionally, we consider other factors when estimating our current period return provision, including levels of inventory in our distribution channel as well as significant market changes which may impact future expected returns, and make adjustments to our current period provision for returns when it appears product returns may differ from our original estimates.

[Table of Contents](#)

Pricing adjustments, which include shelf stock adjustments, are credits issued to reflect price decreases in selling prices charged to our direct customers. Shelf stock adjustments are based upon the amount of product our customers have in their inventory at the time of an agreed-upon price reduction. The provision for shelf stock adjustments is based upon specific terms with our direct customers and includes estimates of existing customer inventory levels based upon their historical purchasing patterns. We regularly monitor all price changes to help evaluate our reserve balances. The adequacy of these reserves is readily determinable as pricing adjustments and shelf stock adjustments are negotiated and settled on a customer-by-customer basis.

Promotional allowances are credits that are issued in connection with a product launch or as an incentive for customers to begin carrying our product. We establish a reserve for promotional allowances based upon these contractual terms.

Billback adjustments are credits that are issued to certain customers who purchase directly from us as well as indirectly through a wholesaler. These credits are issued in the event there is a difference between the customer's direct and indirect contract price. The provision for billbacks is estimated based upon historical purchasing patterns of qualified customers who purchase product directly from us and supplement their purchases indirectly through our wholesale customers.

Cash Discounts — Cash discounts are provided to customers that pay within a specific period. The provision for cash discounts are estimated based upon invoice billings, utilizing historical customer payment experience. Our customer's payment experience is fairly consistent and most customer payments qualify for the cash discount. Accordingly, our reserve for cash discounts is readily determinable.

The estimation process used to determine our SRA provision has been applied on a consistent basis and there have been no significant changes in underlying estimates that have resulted in a material adjustment to our SRA reserves. The Company does not expect future payments of SRA to materially exceed our current estimates. However, if future SRA payments were to materially exceed our estimates, such adjustments may have a material adverse impact on our financial position, results of operations and cash flows. For additional information on our reserves for SRA refer to "NOTE 2 — Summary of Significant Accounting Policies" in the accompanying "Notes to Consolidated Financial Statements" in this Annual Report.

Revenue Recognition

Revenue is generally realized or realizable and earned when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectability is reasonably assured. The Company records revenue from product sales when title and risk of ownership have been transferred to the customer, which is typically upon delivery to the customer. Revenues recognized from research, development and licensing agreements (including milestone payments) are recorded on the "contingency-adjusted performance model" which requires deferral of revenue until such time as contract milestone requirements, as specified in the individual agreements, have been met. Under this model, revenue related to each payment is recognized over the entire contract performance period, starting with the contract's commencement, but not prior to earning and/or receiving the milestone payment (i.e., removal of any contingency). The amount of revenue recognized is based on the ratio of costs incurred to date to total estimated cost to be incurred. Royalty and commission revenue is recognized in accordance with the terms of their respective contractual agreements when collectability is reasonably assured and revenue can be reasonably measured.

Inventory Valuation

Inventories consist of finished goods held for distribution, raw materials and work in process. Included in inventory are generic pharmaceutical products that are capitalized only when the bioequivalence of the product is demonstrated or the product is already U.S. Food and Drug Administration approved and is awaiting a contractual triggering event to enter the marketplace. Inventory valuation reserves are established based on a number of factors/situations including, but not limited to, raw materials, work in process, or finished goods not meeting product specifications, product obsolescence, or lower of cost (first-in, first-out method) or market (net realizable value). The determination of events requiring the establishment of inventory valuation reserves,

[Table of Contents](#)

together with the calculation of the amount of such reserves may require judgment. Assumptions utilized in our quantification of inventory reserves include, but are not limited to, estimates of future product demand, consideration of current and future market conditions, product net selling price, anticipated product launch dates, potential product obsolescence and other events relating to special circumstances surrounding certain products. No material adjustments have been required to our inventory reserve estimates for the periods presented. Adverse changes in assumptions utilized in our inventory reserve calculations could result in an increase to our inventory valuation reserves and higher cost of sales.

Investments

We employ a systematic methodology that considers all available evidence in evaluating potential impairment of our investments. In the event that the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, the duration and extent to which the fair value is less than cost, as well as our intent and ability to hold the investment. We also consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, operational and financing cash flow factors, and rating agency actions. However, when a decline in the fair value of an investment falls below the carrying value for a six-month period, unless sufficient positive, objective evidence exists to support such an extended period, the decline will be considered other-than-temporary. Any decline in the market prices of our equity investments that are deemed to be other-than-temporary may require us to incur additional impairment charges.

Our equity investments are accounted for under the equity method when the Company can exert significant influence and ownership does not exceed 50%. We account for joint ventures using the equity method. We record equity method investments at cost and adjust for the appropriate share of investee net earnings or losses. Investments in which the Company owns less than a 20% interest and cannot exert significant influence are accounted for using the cost method if the fair value of such investments is not readily determinable.

All of our marketable securities are classified as available-for-sale and are reported at fair value, based on quoted market prices. Unrealized temporary adjustments to fair value are included on the balance sheet in a separate component of stockholders' equity as unrealized gains and losses and reported as a component of other comprehensive income. No gains or losses on marketable securities are realized until shares are sold or a decline in fair value is determined to be other-than-temporary. If a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established.

Product Rights and Other Definite-Lived Intangible Assets

Our product rights and other definite-lived intangible assets are stated at cost, less accumulated amortization, and are amortized using the straight-line method over their estimated useful lives. We determine amortization periods for product rights and other definite-lived intangible assets based on our assessment of various factors impacting estimated useful lives and cash flows. Such factors include the product's position in its life cycle, the existence or absence of like products in the market, various other competitive and regulatory issues, and contractual terms. Significant changes to any of these factors may result in a reduction in the intangibles useful life and an acceleration of related amortization expense, which could cause our operating income, net income and earnings per share to decline.

Product rights and other definite-lived intangible assets are tested periodically for impairment when events or changes in circumstances indicate that an asset's carrying value may not be recoverable. The impairment testing involves comparing the carrying amount of the asset to the forecasted undiscounted future cash flows. In the event the carrying value of the asset exceeds the undiscounted future cash flows, the carrying value is considered not recoverable and impairment exists. An impairment loss is measured as the excess of the asset's carrying value over its fair value, calculated using a discounted future cash flow method. The computed impairment loss is recognized in net income in the period that the impairment occurs. Our projections of discounted cash flows using a discount rate determined by our management to be commensurate with the risk inherent in our business model. Our estimates of future cash flows attributable to our other definite-lived

[Table of Contents](#)

intangible assets require significant judgment based on our historical and anticipated results and are subject to many factors. Different assumptions and judgments could materially affect the calculation of the fair value of the other definite-lived intangible assets which could trigger impairment.

Goodwill and Intangible Assets with Indefinite-Lives

We test goodwill and intangible assets with indefinite-lives for impairment annually at the end of the second quarter by comparing the fair value of each of the Company's reporting units to the respective carrying value of the reporting units. Additionally, we may perform tests between annual tests if an event occurs or circumstances change that could potentially reduce the fair value of a reporting unit below its carrying amount. The Company's reporting units have been identified by Watson as Global Generics, Global Brands and Distribution. The carrying value of each reporting unit is determined by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units.

Goodwill is considered impaired if the carrying amount of the net assets exceeds the fair value of the reporting unit. Impairment, if any, would be recorded in operating income and this could result in a material reduction in net income and earnings per share. During the second quarter of 2010, the Company performed its annual impairment assessment of goodwill, IPR&D and trade name intangible assets with indefinite-lives and determined there was no impairment. Due to changes in market conditions in certain international locations, the Company performed an off-cycle impairment review in the fourth quarter of 2010 and recorded a \$28.6 million impairment charge related to certain IPR&D assets acquired in the Arrow Acquisition.

Included in intangible assets with indefinite-lives are trade name intangible assets acquired prior to January 1, 2009 and IPR&D intangibles acquired after January 1, 2009. Upon adoption of FASB issued authoritative guidance on January 1, 2009, using the purchase method of accounting, IPR&D intangible assets are recognized at their fair value on the balance sheet regardless of the likelihood of success of the related product or technology. Prior to January 1, 2009, amounts allocated to IPR&D intangible assets were expensed at the date of acquisition.

IPR&D intangible assets represent the value assigned to acquired research and development projects that, as of the date acquired, represent the right to develop, use, sell and/or offer for sale a product or other intellectual property that we have acquired with respect to products and/or processes that have not been completed or approved. The IPR&D intangible assets will be subject to impairment testing until completion or abandonment of each project. Impairment testing will require the development of significant estimates and assumptions involving the determination of estimated net cash flows for each year for each project or product (including net revenues, cost of sales, research and development costs, selling and marketing costs), the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset's life cycle, competitive trends impacting the asset and each cash flow stream as well as other factors. The major risks and uncertainties associated with the timely and successful completion of the IPR&D projects include legal risk and regulatory risk. Changes in these assumptions or uncertainties could result in future impairment charges. No assurances can be given that the underlying assumptions used to prepare the discounted cash flow analysis will not change or the timely completion of each project to commercial success will occur. For these and other reasons, actual results may vary significantly from estimated results.

Upon successful completion of each project and launch of the product, Watson will make a separate determination of useful life of the intangible, transfer the amount to currently marketed products and amortization expense will be recorded over the estimated useful life.

Allocation of Acquisition Fair Values to Assets Acquired and Liabilities Assumed

We account for acquired businesses using the purchase method of accounting, which requires that assets acquired and liabilities assumed be recorded at date of acquisition at their respective fair values. The consolidated financial statements and results of operations reflect an acquired business after the completion of the acquisition. The fair value of the consideration paid, including contingent consideration, is allocated to the underlying net assets of the acquired business based on their respective fair values. Any excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill. Beginning in 2009,

[Table of Contents](#)

amounts allocated to IPR&D are included on the balance sheet (refer to discussion above in "Goodwill and Intangible Assets with Indefinite Lives"). Intangible assets, including IPR&D assets upon successful completion of the project and launch of the product, are amortized on a straight-line basis to amortization expense over the expected life of the asset. Significant judgments are used in determining the estimated fair values assigned to the assets acquired and liabilities assumed and in determining estimates of useful lives of long-lived assets. Fair value determinations and useful life estimates are based on, among other factors, estimates of expected future net cash flows, estimates of appropriate discount rates used to present value expected future net cash flow streams, the timing of approvals for IPR&D projects and the timing of related product launch dates, the assessment of each asset's life cycle, the impact of competitive trends on each asset's life cycle and other factors. These judgments can materially impact the estimates used to allocate acquisition date fair values to assets acquired and liabilities assumed and the resulting timing and amount of amounts charged to, or recognized in current and future operating results. For these and other reasons, actual results may vary significantly from estimated results.

The Company determines the acquisition date fair value of contingent consideration obligations based on a probability-weighted income approach derived from revenue estimates, post-tax gross profit levels and a probability assessment with respect to the likelihood of achieving contingent obligations including contingent payments such as milestone obligations, royalty obligations and contract earn-out criteria, where applicable. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows are discounted using an appropriate effective annual interest rate. At each reporting date, the contingent consideration obligation will be revalued to estimated fair value and changes in fair value will be reflected as income or expense in our consolidated statement of operations. Changes in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various contingent payment obligations. Adverse changes in assumptions utilized in our contingent consideration fair value estimates could result in an increase in our contingent consideration obligation and a corresponding charge to operating income.

RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the FASB issued an amendment to its accounting guidance on revenue arrangements with multiple deliverables, which addresses the unit of accounting for arrangements involving multiple deliverables and how consideration should be allocated to separate units of accounting, when applicable. The amendment requires that arrangement considerations be allocated at the inception of the arrangement to all deliverables using the relative selling price method and provides for expanded disclosures related to such arrangements. The amendment is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is allowed. The adoption of the statement will not have a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued an amendment to the disclosure requirements for fair value measurements. The amendment requires an entity to: (i) disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and (ii) present separate information for Level 3 activity pertaining to gross purchases, sales, issuances and settlements. The new disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the Level 3 disclosures, which are effective for fiscal years beginning after December 15, 2010. The adoption of the statement will not have a material impact on the Company's consolidated financial statements.

In March 2010, the FASB ratified accounting guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. This guidance provides criteria that must be met to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. The amendment is effective for milestones achieved in fiscal years beginning on or after June 15, 2010. Early adoption is allowed. The adoption of the statement will not have a material impact on the Company's consolidated financial statements.

[Table of Contents](#)

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES 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.

We maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including both government and government agency obligations with ratings of AA or better, money market funds with ratings of AAm or better, and time deposits with financial institutions with short-term ratings of A-1/P-1 or higher by S&P and Moody's, respectively. Our investments in marketable securities are governed by our investment policy which seeks to preserve the value of our principal, provide liquidity and maximize return on the Company's investments. Additionally, our investment policy limits the amount invested with any one counterparty and places limits on an investments maximum maturity. Consequently, our interest rate and principal risk are minimal on our non-equity investment portfolio. The quantitative and qualitative disclosures about market risk are set forth below.

Investment Risk

As of December 31, 2010, our total holdings in equity securities of other companies, including equity method investments and available-for-sale securities, were \$64.3 million. Of this amount, we had equity method investments of \$40.2 million and publicly traded equity securities (available-for-sale securities) at fair value totaling \$23.9 million (included in marketable securities and investments and other assets). The fair values of these investments are subject to significant fluctuations due to volatility of the stock market and changes in general economic conditions.

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

Interest Rate Risk

Our exposure to interest rate risk relates primarily to our non-equity investment. Our cash is invested in bank deposits and AAm-rated money market mutual funds.

Our portfolio of marketable securities includes 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 that an increase in market rates would have a significant negative impact on the realized value of our portfolio.

Based on the quoted market value of our Senior Notes as of December 31, 2010, the fair value was \$71.0 million greater 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.

We operate and transact business in various foreign countries and are, therefore, subject to the risk of foreign currency exchange rate fluctuations. Net foreign currency gains and losses did not have a material effect on the Company's results of operations for 2010, 2009 or 2008.

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

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

[Table of Contents](#)

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this Item is contained in the financial statements set forth in Item 15 (a) under the caption *Consolidated Financial Statements and Supplementary Data* as a part of this Annual Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There have been no changes in or disagreements with accountants on accounting or financial disclosure matters.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains "disclosure controls and procedures," as such term is defined under Rule 13a-15(e) of the Exchange Act, that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's ("SEC's") rules and forms, and that such information is accumulated and communicated to the Company's management, including its Principal Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, the Company has investments in certain unconsolidated entities. However, our assessment of the disclosure controls and procedures with respect to the Company's equity method investees did include an assessment of the controls over the recording of amounts related to our investments that are recorded in our consolidated financial statements, including controls over the selection of accounting methods for our investments, the recognition of equity method earnings and losses and the determination, valuation and recording of our investment account balances.

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 December 31, 2010. Based on this evaluation, the Company's Principal Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective at a reasonable assurance level as of December 31, 2010.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate "internal control over financial reporting," as such term is defined under Rule 13a-15(f) of the Exchange Act. We maintain internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Therefore, internal control over financial reporting determined to be effective provides only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Under the supervision and with the participation of management, including the Company's Principal Executive Officer and Principal Financial Officer, the Company conducted an evaluation of the effectiveness

[Table of Contents](#)

of its internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included an assessment of the design of the Company's internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Based on this evaluation, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2010.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2010 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears under Item 15(a)(1) of this Form 10-K.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting, during the fiscal quarter ended December 31, 2010, that has materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

We have filed with the New York Stock Exchange the most recent annual Chief Executive Officer Certification as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors

The information concerning directors of Watson required under this Item is incorporated herein by reference from our definitive proxy statement, to be filed pursuant to Regulation 14A, related to our 2011 Annual Meeting of Stockholders to be held on May 13, 2011 (our "2011 Proxy Statement").

Information concerning our Audit Committee and the independence of its members, along with information about the financial expert(s) serving on the Audit Committee, is set forth in the Audit Committee section of our 2011 Proxy Statement and is incorporated herein by reference.

Executive Officers of the Registrant

Below are our executive officers as of February 21, 2011:

<u>Name</u>	<u>Age</u>	<u>Principal Position with Registrant</u>
Paul M. Bisaro	50	President and Chief Executive Officer
Sigurdur O. Olafsson	42	Executive Vice President, Global Generics
G. Frederick Wilkinson	54	Executive Vice President, Global Brands
Albert Paonessa, III	50	Executive Vice President, Chief Operating Officer, Distribution Division
Robert A. Stewart	43	Executive Vice President, Global Operations
R. Todd Joyce	53	Senior Vice President, Chief Financial Officer
David A. Buchen	46	Senior Vice President, General Counsel, and Secretary
Clare Carmichael	51	Senior Vice President, Human Resources
Charles M. Mayr	54	Senior Vice President, Corporate Affairs

[Table of Contents](#)

Paul M. Bisaro

Paul M. Bisaro, age 50, has served as President and Chief Executive Officer since September 2007. Prior to joining Watson, Mr. Bisaro was President and Chief Operating Officer of Barr Pharmaceuticals, Inc. ("Barr") from 1999 to 2007. Between 1992 and 1999, Mr. Bisaro served as General Counsel and from 1997 to 1999 served in various additional capacities including Senior Vice President — Strategic Business Development. Prior to joining Barr, he was associated with the law firm Winston & Strawn and a predecessor firm, Bishop, Cook, Purcell and Reynolds from 1989 to 1992. Mr. Bisaro also served as a Senior Consultant with Arthur Andersen & Co. Mr. Bisaro received his undergraduate degree in General Studies from the University of Michigan in 1983 and a Juris Doctor from Catholic University of America in Washington, D.C. in 1989.

Sigurdur O. Olafsson

Sigurdur O. Olafsson, age 42, was appointed Executive Vice President, Global Generics Division on September 1, 2010. Prior to joining Watson, Mr. Olafsson served as Chief Executive Officer of the Actavis Group from 2008 to 2010. From 2006 until 2008 Mr. Olafsson served as Deputy CEO of the Actavis Group and was CEO, Actavis Inc. U.S. and Chief Executive Corporate Development from 2003 to 2006, where he led Actavis' sales and marketing organization. Prior to joining Actavis, he held a number of senior positions with Pfizer's Global Research and Development organization in both the U.S. and the U.K. from 1998 to 2003. Prior to joining Pfizer, he served as Head of Drug Development for Omega Farma in Iceland for four years. Mr. Olafsson has a M.S. in Pharmacy (Cand Pharm) from the University of Reykjavik.

G. Frederick Wilkinson

G. Frederick Wilkinson, age 54, was appointed Executive Vice President, Global Brands on September 21, 2009. Prior to joining Watson, Mr. Wilkinson was President and Chief Operating Officer of Duramed Pharmaceuticals, Inc. the proprietary products subsidiary of Barr from 2006 to 2009. Prior to joining Duramed Pharmaceuticals, Inc., he was President and Chief Executive Officer of Columbia Laboratories, Inc. from 2001 to 2006. From 1996 to 2001, Mr. Wilkinson was Senior Vice President and Chief Operating Officer of Watson Pharmaceuticals, Inc. Prior to joining Watson, he spent sixteen years at Sandoz in numerous senior management positions of increasing responsibility. Mr. Wilkinson received his M.B.A. from Capital University in 1984 and his B.S. in Pharmacy from Ohio Northern University in 1979.

Albert Paonessa III

Albert Paonessa, age 50, has served as our Executive Vice President, Chief Operating Officer of Anda, our Distribution company following our acquisition of Andrx. Mr. Paonessa was appointed Anda Executive Vice President and Chief Operating Officer in August 2005 and had been with Anda since Andrx acquired VIP in March 2000. From March 2000 through January 2002, Mr. Paonessa was Vice President, Operations of VIP. In January 2002, he became Vice President, Information Systems at Anda and in January 2004 was appointed Senior Vice President, Sales at Anda. Mr. Paonessa received a B.A. and a B.S. from Bowling Green State University in 1983.

Robert A. Stewart

Robert A. Stewart, age 43, was appointed Executive Vice President, Global Operations on August 3, 2010. Mr. Stewart joined Watson in November 2009 as Senior Vice President, Global Operations. Prior to joining Watson, Mr. Stewart held various positions with Abbott Laboratories, Inc. from 2002 until 2009 where he most recently served as Vice President, Global Supply Chain. From 2005 until 2008, he served as Divisional Vice President, Quality Assurance and prior to this position served as Divisional Vice President for U.S./Puerto Rico and Latin America Plant Operations as well as Director of Operations for Abbott's Whippany plant. Prior to joining Abbott Laboratories, Inc., he worked for Knoll Pharmaceutical Company from 1995 to 2001 and Hoffman La-Roche Inc. Mr. Stewart received B.S. degrees in Business Management / Finance in 1994 from Fairleigh Dickinson University.

[Table of Contents](#)

R. Todd Joyce

R. Todd Joyce, age 53, was appointed Senior Vice President, Chief Financial Officer of Watson on October 30, 2009. Mr. Joyce joined Watson in 1997 as Corporate Controller, and was named Vice President, Corporate Controller and Treasurer in 2001. During the periods October 2006 to November 2007 and from July 2009 until his appointment as Chief Financial Officer, Mr. Joyce served as interim Principal Financial Officer. Prior to joining Watson, Mr. Joyce served as Vice President of Tax from 1992 to 1996 and as Vice President of Tax and Finance from 1996 until 1997 at ICN Pharmaceuticals. Prior to ICN Pharmaceuticals, Mr. Joyce served as a Certified Public Accountant with Coopers & Lybrand and Price Waterhouse. Mr. Joyce received a B.S. in Business Administration from the University of North Carolina at Chapel Hill in 1983 and a M.S. in Taxation from Golden State University in 1992.

David A. Buchen

David A. Buchen, age 46, has served as Senior Vice President, General Counsel and Secretary since November 2002. From November 2000 to November 2002, Mr. Buchen served as Vice President and Associate General Counsel. From February 2000 to November 2000, he served as Vice President and Senior Corporate Counsel. From November 1998 to February 2000, he served as Senior Corporate Counsel and as Corporate Counsel. He also served as Assistant Secretary from February 1999 to November 2002. Prior to joining Watson, Mr. Buchen was Corporate Counsel at Bausch & Lomb Surgical (formerly Chiron Vision Corporation) from November 1995 until November 1998 and was an attorney with the law firm of Fulbright & Jaworski, LLP. Mr. Buchen received a B.A. in Philosophy from the University of California, Berkeley in 1985, and a Juris Doctor with honors from George Washington University Law School in 1989.

Clare Carmichael

Clare Carmichael, age 51, was appointed Senior Vice President, Human Resources of Watson effective August 12, 2008. Prior to joining Watson, Ms. Carmichael was Vice President, Human Resources for Schering-Plough Research Institute. Ms. Carmichael was Vice President, Human Resources for Eyetech Pharmaceuticals Inc. from 2003 to 2005. She also held positions of increasing responsibility at Pharmacia Corporation until 2003. Ms. Carmichael received a B.A. in Psychology from Rider University in 1981.

Charles M. Mayr

Charles M. Mayr, age 54, was appointed Senior Vice President, Corporate Affairs of Watson effective September 2009. Prior to joining Watson, Mr. Mayr operated an advertising and public relations consulting company, serving such clients as Watson, the Generic Pharmaceuticals Association, Barr and a variety of professional associations and consumer products and service companies. Prior to starting his consultancy business, he served as director of corporate communications for Barr. Prior to joining Barr, he served as director of global communications for Sterling Drug Inc., the global brand and consumer health products pharmaceutical subsidiary of Kodak. Mr. Mayr began his career as a broadcast and print journalist and has a B.A. in journalism from New York University.

Our executive officers are appointed annually by the Board of Directors, hold office until their successors are chosen and qualified, and may be removed at any time by the affirmative vote of a majority of the Board of Directors. We have employment agreements with most of our executive officers. There are no family relationships between any director and executive officer of Watson.

Section 16(a) Compliance

Information concerning compliance with Section 16(a) of the Securities Exchange Act of 1934 will be set forth in the Section 16(a) Beneficial Ownership Reporting Compliance section of our 2011 Proxy Statement and is incorporated herein by reference.

[Table of Contents](#)

Code of Ethics

Watson has adopted a Code of Conduct that applies to our employees, including our principal executive officer, principal financial officer and principal accounting officer. The Code of Conduct is posted on our Internet website at www.watson.com. Any person may request a copy of our Code of Conduct by contacting us at 311 Bonnie Circle, Corona, California, 92880, Attn: Secretary. Any amendments to or waivers from the Code of Conduct will be posted on our website at www.watson.com under the caption "Corporate Governance" within the Investors section of our website.

ITEM 11. EXECUTIVE COMPENSATION

The information concerning executive and director compensation, and concerning our compensation committee and the compensation committee report for Watson required under this Item is incorporated herein by reference to the "Compensation Discussion and Analysis" section of our 2011 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information concerning security ownership of certain beneficial owners and management and related stockholder matters and the equity compensation plan information required under this Item is incorporated herein by reference to the "Beneficial Ownership of Stockholders, Directors and Executive Officers" and "Equity Compensation Plan Information as of December 31, 2010" sections of our 2011 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information concerning certain relationships and related transactions, and director independence required under this Item is incorporated herein by reference to the "Certain Relationships and Related Transactions" and "Director Independence" sections of our 2011 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information concerning principal accountant fees and services required under this Item is incorporated herein by reference to the "Audit Fees" section of our 2011 Proxy Statement.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. *Consolidated Financial Statements and Supplementary Data*

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets as of December 31, 2010 and 2009	F-3
Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008	F-4
Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008	F-5
Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2010, 2009 and 2008	F-6
Notes to Consolidated Financial Statements	F-7
Supplementary Data (Unaudited)	F-49

2. *Financial Statement Schedule*

	<u>Page</u>
Schedule II — Valuation and Qualifying Accounts	F-48

All other financial statement schedules have been omitted because they are not applicable or the required information is included in the Consolidated Financial Statements or notes thereto.

3. *Exhibits*

Reference is hereby made to the Exhibit Index immediately following page F-49 Supplementary Data (Unaudited) of this Annual Report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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/ PAUL M. BISARO**
Paul M. Bisaro
President and Chief Executive Officer
(Principal Executive Officer)

Date: February 21, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Paul M. Bisaro Paul M. Bisaro	President, Chief Executive Officer and Director	February 21, 2011
/s/ R. Todd Joyce R. Todd Joyce	Senior Vice President — Chief Financial Officer (Principal Financial Officer)	February 21, 2011
/s/ Andrew L. Turner Andrew L. Turner	Chairman	February 21, 2011
/s/ Christopher W. Bodine Christopher W. Bodine	Director	February 21, 2011
/s/ Michael J. Fedida Michael J. Fedida	Director	February 21, 2011
/s/ Michel J. Feldman Michel J. Feldman	Director	February 21, 2011
/s/ Albert F. Hummel Albert F. Hummel	Director	February 21, 2011
/s/ Catherine M. Klema Catherine M. Klema	Director	February 21, 2011
/s/ Jack Michelson Jack Michelson	Director	February 21, 2011
/s/ Tony S. Tabatznik Tony S. Tabatznik	Director	February 21, 2011
/s/ Ronald R. Taylor Ronald R. Taylor	Director	February 21, 2011
/s/ Fred G. Weiss Fred G. Weiss	Director	February 21, 2011

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets as of December 31, 2010 and 2009	F-3
Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008	F-4
Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008	F-5
Consolidated Statements of Stockholders' Equity and Comprehensive Income for the years ended December 31, 2010, 2009 and 2008	F-6
Notes to Consolidated Financial Statements	F-7
Supplementary Data (Unaudited)	F-49
Financial Statement Schedule	
Schedule II - Valuation and Qualifying Accounts	F-48

All other financial statement schedules have been omitted because they are not applicable or the required information is included in the Consolidated Financial Statements or notes thereto.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
of Watson Pharmaceuticals, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows, of stockholders' equity and of comprehensive income present fairly, in all material respects, the financial position of Watson Pharmaceuticals, Inc. and its subsidiaries at December 31, 2010 and December 31, 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Orange County, CA
February 21, 2011

**WATSON PHARMACEUTICALS, INC.
CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2010	2009
	(Revised)	
	(In millions, except par value)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 282.8	\$ 201.4
Marketable securities	11.1	13.6
Accounts receivable, net of allowances for doubtful accounts of \$12.5 and \$5.4	560.9	517.4
Inventories, net	631.0	692.3
Prepaid expenses and other current assets	134.2	213.9
Deferred tax assets	179.4	130.9
Total current assets	1,799.4	1,769.5
Property and equipment, net	642.3	694.2
Investments and other assets	84.5	114.5
Deferred tax assets	141.0	110.8
Product rights and other intangibles, net	1,632.0	1,713.5
Goodwill	1,528.1	1,501.0
Total assets	<u>\$5,827.3</u>	<u>\$5,903.5</u>
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 741.1	\$ 614.3
Income taxes payable	39.9	78.4
Short-term debt and current portion of long-term debt	—	307.6
Deferred tax liabilities	20.8	31.3
Deferred revenue	18.9	16.3
Total current liabilities	820.7	1,047.9
Long-term debt	1,016.1	1,150.2
Deferred revenue	18.2	31.9
Other long-term liabilities	183.1	118.7
Other taxes payable	65.1	76.0
Deferred tax liabilities	441.5	455.7
Total liabilities	<u>2,544.7</u>	<u>2,880.4</u>
Commitments and contingencies		
Equity:		
Preferred stock; no par value per share; 2.5 shares authorized	—	—
Common stock; \$0.0033 par value per share; 500.0 shares authorized 135.5 and 133.0 shares issued and 125.8 and 123.4 shares outstanding, respectively	0.4	0.4
Additional paid-in capital	1,771.8	1,686.9
Retained earnings	1,824.5	1,640.1
Accumulated other comprehensive (loss) income	(2.5)	1.9
Treasury stock, at cost; 9.7 and 9.6 shares held, respectively	(312.5)	(306.2)
Total stockholders' equity	3,281.7	3,023.1
Noncontrolling interest	0.9	—
Total equity	<u>3,282.6</u>	<u>3,023.1</u>
Total liabilities and equity	<u>\$5,827.3</u>	<u>\$5,903.5</u>

See accompanying Notes to Consolidated Financial Statements.

**WATSON PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS**

	Years Ended December 31,		
	2010	2009	2008
	(In millions, except per share amounts)		
Net revenues	\$ 3,566.9	\$ 2,793.0	\$ 2,535.5
Operating expenses:			
Cost of sales (excludes amortization, presented below)	1,998.5	1,596.8	1,502.8
Research and development	296.1	197.3	170.1
Selling and marketing	320.0	263.1	232.9
General and administrative	436.1	257.1	190.5
Amortization	180.0	92.6	80.7
Loss on asset sales and impairments	30.8	2.2	0.3
Total operating expenses	<u>3,261.5</u>	<u>2,409.1</u>	<u>2,177.3</u>
Operating income	<u>305.4</u>	<u>383.9</u>	<u>358.2</u>
Other (expense) income:			
Interest income	1.6	5.0	9.0
Interest expense	(84.1)	(34.2)	(28.2)
Other income	27.7	7.9	19.3
Total other (expense) income, net	<u>(54.8)</u>	<u>(21.3)</u>	<u>0.1</u>
Income before income taxes and noncontrolling interest	250.6	362.6	358.3
Provision for income taxes	67.3	140.6	119.9
Net income	183.3	222.0	238.4
Loss attributable to noncontrolling interest	1.1	—	—
Net income attributable to common shareholders	<u>\$ 184.4</u>	<u>\$ 222.0</u>	<u>\$ 238.4</u>
Earnings per share:			
Basic	<u>\$ 1.51</u>	<u>\$ 2.11</u>	<u>\$ 2.32</u>
Diluted	<u>\$ 1.48</u>	<u>\$ 1.96</u>	<u>\$ 2.09</u>
Weighted average shares outstanding:			
Basic	<u>122.4</u>	<u>105.0</u>	<u>102.8</u>
Diluted	<u>124.2</u>	<u>116.4</u>	<u>117.7</u>

See accompanying Notes to Consolidated Financial Statements.

WATSON PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2010	2009	2008
	(In millions)		
Cash Flows From Operating Activities:			
Net income	\$ 183.3	\$ 222.0	\$ 238.4
Reconciliation to net cash provided by operating activities:			
Depreciation	101.9	96.4	90.0
Amortization	180.0	92.6	80.7
Provision for inventory reserve	50.0	51.0	45.7
Share-based compensation	23.5	19.1	18.5
Deferred income tax (benefit) provision	(118.3)	(19.0)	3.5
(Gain) loss on sale of securities	(27.3)	1.1	(9.6)
Loss on asset sales and impairment	29.8	2.6	0.3
Increase in allowance for doubtful accounts	9.5	3.4	1.2
Accretion of preferred stock and contingent payment consideration	38.4	2.2	—
Other, net	11.3	(7.6)	(13.9)
Changes in assets and liabilities (net of effects of acquisitions):			
Accounts receivable, net	(57.1)	(108.2)	(39.1)
Inventories	10.5	(82.2)	(28.2)
Prepaid expenses and other current assets	55.4	9.1	33.3
Accounts payable and accrued expenses	96.5	72.0	(17.6)
Deferred revenue	(10.6)	2.0	(14.5)
Income taxes payable	(20.8)	16.9	24.6
Other assets	15.0	3.4	3.3
Total adjustments	387.7	154.8	178.2
Net cash provided by operating activities	571.0	376.8	416.6
Cash Flows From Investing Activities:			
Additions to property and equipment	(56.6)	(55.4)	(63.5)
Additions to product rights and other intangibles	(10.9)	(16.5)	(37.0)
Additions to marketable securities	(5.5)	(8.0)	(8.2)
Additions to long-term investments	(43.7)	—	—
Proceeds from sale of property and equipment	2.7	3.0	—
Proceeds from sales of marketable securities	9.5	9.0	6.7
Proceeds from sale of investments	95.4	—	8.2
Acquisition of business, net of cash acquired	(67.5)	(968.2)	—
Other investing activities, net	2.5	—	0.4
Net cash used in investing activities	(74.1)	(1,036.1)	(93.4)
Cash Flows From Financing Activities:			
Proceeds from issuance of long-term debt	—	1,109.9	—
Principal payments on debt	(459.7)	(786.6)	(95.6)
Proceeds from borrowings on short-term debt	—	—	67.9
Proceeds from stock plans	54.7	33.4	8.4
Repurchase of common stock	(6.3)	(3.6)	(0.9)
Net cash (used in) provided by financing activities	(411.3)	353.1	(20.2)
Effect of currency exchange rate changes on cash and cash equivalents	(4.2)	—	—
Net increase (decrease) in cash and cash equivalents	81.4	(306.2)	303.0
Cash and cash equivalents at beginning of period	201.4	507.6	204.6
Cash and cash equivalents at end of period	\$ 282.8	\$ 201.4	\$ 507.6
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the year for:			
Interest	\$ 49.4	\$ 17.3	\$ 24.4
Income taxes, net of refunds	\$ 193.9	\$ 142.7	\$ 91.8

See accompanying Notes to Consolidated Financial Statements.

**WATSON
PHARMACEUTICALS, INC.
CONSOLIDATED
STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE
INCOME**

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
BALANCE, January 1, 2008	113.1	\$ 0.4	\$ 968.8	\$ 1,179.7	\$ 2.4	(9.5)	\$ (301.7)	\$ 1,849.6
Comprehensive income:								
Net income	—	—	—	238.4	—	—	—	238.4
Unrealized losses on securities, net of tax	—	—	—	—	(1.0)	—	—	(1.0)
Unrealized loss on cash flow hedge, net of tax	—	—	—	—	0.9	—	—	0.9
Translation adjustment	—	—	—	—	(5.5)	—	—	(5.5)
Total comprehensive income	—	—	—	—	—	—	—	232.8
Share-based compensation	—	—	18.5	—	—	—	—	18.5
Common stock issued under employee stock plans	1.0	—	8.4	—	—	—	—	8.4
Tax benefits from exercise of options	—	—	0.2	—	—	—	—	0.2
Repurchase of common stock	—	—	—	—	—	—	(0.9)	(0.9)
BALANCE, December 31, 2008	114.1	\$ 0.4	\$ 995.9	\$ 1,418.1	\$ (3.2)	(9.5)	\$ (302.6)	\$ 2,108.6
Comprehensive income:								
Net income	—	—	—	222.0	—	—	—	222.0
Unrealized gains on securities, net of tax	—	—	—	—	3.3	—	—	3.3
Translation adjustment	—	—	—	—	1.8	—	—	1.8
Total comprehensive income	—	—	—	—	—	—	—	227.1
Share-based compensation	—	—	19.1	—	—	—	—	19.1
Common stock issued under employee stock plans	2.0	—	33.4	—	—	—	—	33.4
Common stock issued on acquisition	16.9	—	636.2	—	—	—	—	636.2
Tax benefits from exercise of options	—	—	2.3	—	—	—	—	2.3
Repurchase of common stock	—	—	—	—	—	(0.1)	(3.6)	(3.6)
BALANCE, December 31, 2009	133.0	\$ 0.4	\$ 1,686.9	\$ 1,640.1	\$ 1.9	(9.6)	\$ (306.2)	\$ 3,023.1
Comprehensive income:								
Net income	—	—	—	184.4	—	—	—	184.4
Unrealized gains on securities, net of tax	—	—	—	—	7.1	—	—	7.1
Translation adjustment	—	—	—	—	(11.5)	—	—	(11.5)
Total comprehensive income	—	—	—	—	—	—	—	180.0
Share-based compensation	—	—	23.5	—	—	—	—	23.5
Common stock issued under employee stock plans	2.5	—	54.7	—	—	—	—	54.7
Tax benefits from exercise of options	—	—	6.7	—	—	—	—	6.7
Repurchase of common stock	—	—	—	—	—	(0.1)	(6.3)	(6.3)
BALANCE, December 31, 2010	135.5	\$ 0.4	\$ 1,771.8	\$ 1,824.5	\$ (2.5)	(9.7)	\$ (312.5)	\$ 3,281.7

See accompanying Notes to Consolidated Financial Statements.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — Description of Business

Watson Pharmaceuticals, Inc. ("Watson" or the "Company") is primarily engaged in the development, manufacturing, marketing, sale and distribution of brand and 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 in the United States of America ("U.S.") and, beginning in 2009, in key international markets including Western Europe, Canada, Australasia, South America and South Africa.

Acquisition of Arrow Group

On December 2, 2009 (the "Acquisition Date"), Watson completed its acquisition of all the outstanding equity of Robin Hood Holdings Limited, a Malta private limited liability company, and Cobalt Laboratories, Inc., a Delaware corporation (together the "Arrow Group"). The Arrow Group is principally engaged in the manufacture and distribution of generic pharmaceuticals and operates in the U.S. and international markets including Western Europe, Canada, Australasia, South America and South Africa.

As a result of the acquisition of the Arrow Group, Watson also acquired a 36% ownership interest in Eden Biopharm Group Limited ("Eden"), a company which provides development and manufacturing services for early-stage biotech companies. In January 2010, we repurchased the remaining interest in Eden for \$15.0 million. Eden's results are included in the Global Brands segment. For additional information on the acquisition of the Arrow Group, refer to "NOTE 4 — Acquisitions and Divestitures."

NOTE 2 — Summary of Significant Accounting Policies

Basis of Presentation

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S. ("GAAP"). The consolidated financial statements include the accounts of wholly-owned subsidiaries, after elimination of intercompany accounts and transactions. Certain prior year amounts have been reclassified to conform to the current-year presentation.

Our consolidated financial statements include the financial results of the Arrow Group subsequent to the Acquisition Date.

Use of Estimates

Management is required to make certain estimates and assumptions in order to prepare consolidated financial statements in conformity with GAAP. Such estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The Company's most significant estimates relate to the determination of sales returns and allowances ("SRA") for accounts receivable and accrued liabilities, valuation of inventory balances, the determination of useful lives for intangible assets and the assessment of expected cash flows used in evaluating goodwill and other long-lived assets for impairment. The estimation process required to prepare the Company's consolidated financial statements requires assumptions to be made about future events and conditions, and as such, is inherently subjective and uncertain. Watson's actual results could differ materially from those estimates.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Foreign Currency Translation

For most of the Company's international operations, the local currency has been determined to be the functional currency. We translate functional currency assets and liabilities to their U.S. dollar equivalents at rates in effect at the balance sheet date and record these translation adjustments as a component of accumulated other comprehensive income (loss) within stockholders' equity in the consolidated balance sheets. We translate functional currency statement of income amounts to their U.S. dollar equivalents at the average rates for the period. The effects of converting non-functional currency assets and liabilities into the functional currency are recorded as general and administrative expenses in the consolidated statements of operations.

Cash and Cash Equivalents

The Company considers cash and cash equivalents to include cash in banks, commercial paper and deposits with financial institutions that can be liquidated without prior notice or penalty. The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Fair Value of Other Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, marketable securities, accounts and other receivables, investments, trade accounts payable, our \$450.0 million aggregate principal amount of 5.000% notes due August 14, 2014 (the "2014 Notes") and \$400.0 million aggregate principal amount of 6.125% notes due August 14, 2019 (the "2019 Notes") (together the "Senior Notes") and our Senior Credit Facility with Canadian Imperial Bank of Commerce, acting through its New York agency, as administrative agent (the "2006 Credit Facility"). The carrying amounts of cash and cash equivalents, marketable securities, accounts and other receivables and trade accounts payable are representative of their respective fair values due to their relatively short maturities. The fair values of investments in companies that are publicly traded are based on quoted market prices. The Company estimates the fair value of its fixed rate long-term obligations based on quoted market rates of interest and maturity schedules for similar issues. At December 31, 2010, the fair value of our Senior Notes was approximately \$71.0 million greater than the carrying value.

Inventories

Inventories consist of finished goods held for sale and distribution, raw materials and work in process. Included in inventory at December 31, 2010 and 2009 is approximately \$4.6 million and \$14.1 million, respectively, of inventory that is pending approval by the U.S. Food and Drug Administration ("FDA"), by other regulatory agencies or has not been launched due to contractual restrictions. This inventory consists of generic pharmaceutical products that are capitalized only when the bioequivalence of the product is demonstrated or the product has already received regulatory approval 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). The Company writes down inventories to net realizable value based on forecasted demand and market conditions, which may differ from actual results.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Major renewals and improvements are capitalized, while routine maintenance and repairs are expensed as incurred. Costs associated with internally developed software are accounted for in accordance with the guidance for the treatment of costs associated with computer software development that defines those costs to be capitalized and those to be expensed. The Company capitalizes interest on qualified construction projects. At the time property and equipment are retired from service, the cost and accumulated depreciation is removed from the respective accounts and the related gains or losses are reflected in income.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Depreciation expense is computed principally on the straight-line method, over estimated useful lives of the related assets. The following table provides the range of estimated useful lives used for each asset type:

Computer software / hardware	3-7 years
Machinery and equipment	5-18 years
Research and laboratory equipment	5-10 years
Furniture and fixtures	5-10 years
Buildings, improvements, leasehold improvements and other	5-40 years

The Company assesses property and equipment for impairment whenever events or changes in circumstances indicate that an asset's carrying amount may not be recoverable.

Investments

The Company's equity investments are accounted for under the equity method when the Company can exert significant influence and ownership does not exceed 50%. Watson accounts for its joint ventures using the equity method. The Company records equity method investments at cost and adjust for the appropriate share of investee net earnings or losses. Investments in which the Company owns less than a 20% interest and cannot exert significant influence are accounted for using the cost method if the fair value of such investments is not readily determinable.

Marketable Securities

The Company's marketable securities consist of U.S. Treasury and agency securities and equity securities of publicly-held companies. The Company's marketable securities are classified as available-for-sale and are recorded at fair value, based upon quoted market prices. Unrealized temporary adjustments to fair value are included on the balance sheet in a separate component of stockholders' equity as unrealized gains and losses and reported as a component of accumulated other comprehensive income. No gains or losses on marketable securities are realized until shares are sold or a decline in fair value is determined to be other-than-temporary. If a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established.

Goodwill and Intangible Assets with Indefinite-Lives

We test goodwill and intangible assets with indefinite-lives for impairment annually at the end of the second quarter by comparing the fair value of each of the Company's reporting units to the respective carrying value of the reporting units. Additionally, we may perform tests between annual tests if an event occurs or circumstances change that could potentially reduce the fair value of a reporting unit below its carrying amount. The Company's reporting units have been identified by Watson as Global Generics, Global Brands and Distribution. The carrying value of each reporting unit is determined by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units.

Goodwill is considered impaired if the carrying amount of the net assets exceeds the fair value of the reporting unit. Impairment, if any, would be recorded in operating income and this could result in a material reduction in net income and earnings per share. During the second quarter of 2010, the Company performed its annual impairment assessment of goodwill, acquired in-process research and development ("IPR&D") intangibles and trade name intangible assets with indefinite-lives and determined there was no impairment. Due to changes in market conditions in certain international locations, the Company performed an off-cycle impairment review in the fourth quarter of 2010 and recorded a \$28.6 million impairment charge related to certain IPR&D assets acquired in the Arrow Acquisition. (Refer to "Note 8 — Goodwill, Product Rights and Other Intangibles" for additional details.)

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Included in intangible assets with indefinite-lives are trade name intangible assets acquired prior to January 1, 2009 and IPR&D intangibles acquired after January 1, 2009. Upon adoption of Financial Accounting Standards Board ("FASB") issued authoritative guidance on January 1, 2009, using the purchase method of accounting, IPR&D intangible assets are recognized at their fair value on the balance sheet regardless of the likelihood of success of the related product or technology. Prior to January 1, 2009, amounts allocated to IPR&D intangible assets were expensed at the date of acquisition.

IPR&D intangible assets represent the value assigned to acquired R&D projects that, as of the date acquired, represent the right to develop, use, sell and/or offer for sale a product or other intellectual property that we have acquired with respect to products and/or processes that have not been completed or approved. The IPR&D intangible assets are subject to impairment testing until completion or abandonment of each project. Impairment testing requires the development of significant estimates and assumptions involving the determination of estimated net cash flows for each year for each project or product (including net revenues, cost of sales, R&D costs, selling and marketing costs), the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset's life cycle, competitive trends impacting the asset and each cash flow stream as well as other factors. The major risks and uncertainties associated with the timely and successful completion of the IPR&D projects include legal risk and regulatory risk. Changes in these assumptions or uncertainties could result in future impairment charges. No assurances can be given that the underlying assumptions used to prepare the discounted cash flow analysis will not change or the timely completion of each project to commercial success will occur. For these and other reasons, actual results may vary significantly from estimated results.

Upon successful completion of each project and launch of the product, Watson will make a separate determination of the useful life of the intangible, transfer the amount to currently marketed products ("CMP") and amortization expense will be recorded over the estimated useful life.

Contingent Consideration

Subsequent to January 1, 2009, contingent consideration is recorded at the acquisition date estimated fair value of the contingent payment for all acquisitions. The fair value of the contingent consideration is remeasured at each reporting period with any adjustments in fair value included in our consolidated statement of operations.

Revenue Recognition

Revenue is generally realized or realizable and earned when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectability is reasonably assured. The Company records revenue from product sales when title and risk of ownership have been transferred to the customer, which is typically upon delivery to the customer. Revenues recognized from research, development and licensing agreements (including milestone receipts) are recorded on the "contingency-adjusted performance model" which requires deferral of revenue until such time as contract milestone requirements, as specified in the individual agreements, have been met. Under this model, revenue related to each payment is recognized over the entire contract performance period, starting with the contract's commencement, but not prior to earning and/or receiving the milestone amount (i.e., removal of any contingency). The amount of revenue recognized is based on the ratio of costs incurred to date to total estimated cost to be incurred. Royalty and commission revenue is recognized in accordance with the terms of their respective contractual agreements when collectability is reasonably assured and revenue can be reasonably measured.

Provisions for Sales Returns and Allowances

As is 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 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

WATSON
PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 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.

Chargebacks — 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.

Rebates — Rebates include volume related incentives to direct and indirect customers and Medicaid rebates based on claims from Medicaid benefit providers.

Volume rebates are generally offered to customers as an incentive to continue to carry our products and to encourage greater product sales. These rebate programs include contracted rebates based on customer's purchases made during an applicable monthly, quarterly or annual period. The provision for rebates is estimated based on our customers' contracted rebate programs and our historical experience of rebates paid. Any significant changes to our customer rebate programs are considered in establishing our provision for rebates. The Company continually monitors its customer rebate programs to ensure that the liability for accrued rebates is fairly stated.

The provision for Medicaid rebates is based upon historical experience of claims submitted by the various states. The Company monitors Medicaid legislative changes to determine what impact such legislation may have on our provision for Medicaid rebates. Our accrual of Medicaid rebates is based on historical payment rates and is reviewed on a quarterly basis against actual claim data to ensure the liability is fairly stated.

Returns and Other Allowances — Our provision for returns and other allowances include returns, pricing adjustments, promotional allowances and billback adjustments.

Consistent with industry practice, the company maintains a return policy that allows our customers to return product for credit. In accordance with our return goods policy, credit for customer returns of product is applied against outstanding account activity or by check. Product exchanges are not permitted. Customer returns of product are not resalable unless the return is due to a shipping error. Our estimate of the provision for returns is based upon historical experience and current trends of actual customer returns. Additionally, we consider other factors when estimating our current period return provision, including levels of inventory in our distribution channel as well as significant market changes which may impact future expected returns, and make adjustments to our current period provision for returns when it appears product returns may differ from our original estimates.

Pricing adjustments, which include shelf stock adjustments, are credits issued to reflect price decreases in selling prices charged to our direct customers. Shelf stock adjustments are based upon the amount of product

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

our customers have in their inventory at the time of an agreed-upon price reduction. The provision for shelf stock adjustments is based upon specific terms with our direct customers and includes estimates of existing customer inventory levels based upon their historical purchasing patterns. The Company regularly monitors all price changes to help evaluate our reserve balances. The adequacy of these reserves is readily determinable as pricing adjustments and shelf stock adjustments are negotiated and settled on a customer-by-customer basis.

Promotional allowances are credits, which are issued in connection with a product launch or as an incentive for customers to begin carrying our product. The Company establishes a reserve for promotional allowances based upon these contractual terms.

Billback adjustments are credits that are issued to certain customers who purchase directly from the Company as well as indirectly through a wholesaler. These credits are issued in the event there is a difference between the customer's direct and indirect contract price. The provision for billbacks is estimated based upon historical purchasing patterns of qualified customers who purchase product directly from the Company and supplement their purchases indirectly through the Company's wholesale customers.

Cash Discounts — Cash discounts are provided to customers that pay within a specific period. The provision for cash discounts are estimated based upon invoice billings, utilizing historical customer payment experience. Our customer's payment experience is fairly consistent and most customer payments qualify for the cash discount. Accordingly, our reserve for cash discounts is readily determinable.

Net revenues and accounts receivable balances in the Company's consolidated financial statements are presented net of SRA estimates. In addition, certain SRA balances are included in accounts payable and accrued liabilities. Accounts receivable are presented net of SRA balances of \$320.5 million and \$335.0 million at December 31, 2010 and 2009, respectively. Accounts payable and accrued liabilities include \$106.5 million and \$83.6 million at December 31, 2010 and 2009, respectively, for certain rebates and other amounts due to indirect customers. The following table summarizes the activity in the Company's major categories of SRA (in millions):

	<u>Chargebacks</u>	<u>Rebates</u>	<u>Returns and Other Allowances</u>	<u>Cash Discounts</u>	<u>Total</u>
Balance at December 31, 2007	\$ 164.4	\$ 154.3	\$ 56.1	\$ 12.9	\$ 387.7
Provision related to sales in 2008	1,224.0	309.1	179.8	67.2	1,780.1
Credits and payments	(1,267.8)	(337.6)	(166.4)	(67.8)	(1,839.6)
Balance at December 31, 2008	120.6	125.8	69.5	12.3	328.2
Add: Arrow Acquisition	5.3	37.0	11.3	1.5	55.1
Provision related to sales in 2009	1,169.0	415.1	183.8	72.8	1,840.7
Credits and payments	(1,177.5)	(389.5)	(167.1)	(71.3)	(1,805.4)
Balance at December 31, 2009 (Revised)	117.4	188.4	97.5	15.3	418.6
Provision related to sales in 2010	1,175.5	755.0	206.5	90.5	2,227.5
Credits and payments	(1,192.1)	(723.5)	(214.7)	(88.8)	(2,219.1)
Balance at December 31, 2010	<u>\$ 100.8</u>	<u>\$ 219.9</u>	<u>\$ 89.3</u>	<u>\$ 17.0</u>	<u>\$ 427.0</u>

The Company does not expect future payments of SRA to materially exceed our current estimates. However, if future SRA payments were to materially exceed our estimates, such adjustments may have a material adverse impact on our financial position, results of operations and cash flows.

Shipping and Handling Costs

The Company records shipping and handling costs in selling and marketing expenses. These expenses were \$66.5 million, \$51.9 million and \$50.8 million in 2010, 2009 and 2008, respectively.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Concentration of Major Customers and Suppliers

For the year ended December 31, 2010, the Company's three largest customers accounted for 14%, 11%, and 6%, individually, of the Company's net revenues. For the year ended December 31, 2009, the Company's three largest customers accounted for 13%, 11%, and 9%, individually, of the Company's net revenues. For the year ended December 31, 2008, the Company's three largest customers accounted for 11%, 11%, and 9%, individually, of the Company's net revenues. No other individual customers accounted for more than 10% of net revenues.

The Company is subject to a concentration of credit risk with respect to its accounts receivable balance, all of which is due from wholesalers, distributors, chain drug stores and service providers in the health care and pharmaceutical industries throughout the U.S. and international markets in which we operate. Approximately 52% and 53% of the gross accounts receivable balance consists of amounts due from the four largest customers at December 31, 2010 and 2009, respectively. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential uncollectible accounts. Actual losses from uncollectible accounts have been minimal.

Certain of the Company's finished products and raw materials are obtained from single source suppliers. Although the Company seeks to identify more than one source for its various finished products and raw materials, loss of a single source supplier could have an adverse effect on the Company's results of operations, financial condition and cash flows. Third-party manufactured products accounted for approximately 33%, 38% and 44% of our Global Generics and Global Brands product net revenues in 2010, 2009 and 2008, respectively.

Research and Development Activities

R&D activities are expensed as incurred and consist of self-funded R&D costs and the costs associated with work performed under collaborative R&D agreements. R&D expenses include direct and allocated expenses. R&D expenses incurred under collaborative agreements were approximately \$11.1 million, \$6.8 million, and \$5.9 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Income Taxes

Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax bases of assets and liabilities at the applicable tax rates. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary. The factors used to assess the likelihood of realization include the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Failure to achieve forecasted taxable income in applicable tax jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company's effective tax rate on future earnings.

Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met. We recognize potential accrued interest and penalties related to unrecognized tax benefits within the consolidated statements of income as income tax expense.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 GAAP, are included in comprehensive income, but excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity. Watson's other comprehensive income (loss) is composed of unrealized gains (losses) on its holdings of publicly traded equity securities, net of realized gains (losses) included in net income and foreign currency translation adjustments.

Earnings Per Share ("EPS")

Basic EPS is computed by dividing net income attributable to common shareholders 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 our convertible contingent senior debentures ("CODES"), and shares issuable pursuant to the exercise of stock options, assuming the exercise of all in-the-money stock options. Common share equivalents have been excluded where their inclusion would be anti-dilutive. The Company is required to add the weighted average potential common shares outstanding 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. On September 14, 2009 the CODES were redeemed in accordance with the terms of the CODES. A reconciliation of the numerators and denominators of basic and diluted EPS consisted of the following (in millions, except per share amounts):

	Years Ended December 31,		
	2010	2009	2008
EPS — basic			
Net income attributable to common shareholders	\$ 184.4	\$ 222.0	\$ 238.4
Basic weighted average common shares outstanding	122.4	105.0	102.8
EPS — basic	\$ 1.51	\$ 2.11	\$ 2.32
EPS — assuming dilution			
Net income attributable to common shareholders	\$ 184.4	\$ 222.0	\$ 238.4
Add: Interest expense on CODES, net of tax	—	5.5	7.9
Net income, adjusted	\$ 184.4	\$ 227.5	\$ 246.3
Basic weighted average common shares outstanding	122.4	105.0	102.8
Effect of dilutive securities:			
Conversion of CODES	—	10.1	14.4
Dilutive stock awards	1.8	1.3	0.5
Diluted weighted average common shares outstanding	124.2	116.4	117.7
EPS — diluted	\$ 1.48	\$ 1.96	\$ 2.09

Stock awards to purchase 1.1 million, 3.5 million and 8.1 million common shares in 2010, 2009 and 2008, respectively, were outstanding but not included in the computation of diluted EPS as the awards were anti-dilutive.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Share-based Compensation

The Company recognizes compensation expense for all share-based compensation awards made to employees and directors based on estimated fair values. The Company estimates the fair value of its stock option plans using the Black-Scholes option pricing model (the "Option Model"). The Option Model requires the use of subjective and complex assumptions, including the option's expected term and the estimated future price volatility of the underlying stock, which determine the fair value of the share-based awards. The Company's estimate of expected term was determined based on the weighted average period of time that options granted are expected to be outstanding considering current vesting schedules and the historical exercise patterns of existing option plans. The expected volatility assumption used in the Option Model is based on implied volatility based on traded options on the Company's stock. The risk-free interest rate used in the Option Model is based on the yield of U.S. Treasuries with a maturity closest to the expected term of the Company's stock options. No stock options were granted during the years ended December 31, 2010, 2009 or 2008.

Share-based compensation expense recognized during a period is based on the value of the portion of share-based awards that are expected to vest with employees. Accordingly, the recognition of share-based compensation expense has been reduced for estimated future forfeitures. These estimates will be revised in future periods if actual forfeitures differ from the estimates. Changes in forfeiture estimates impact compensation expense in the period in which the change in estimate occurs.

Recent Accounting Pronouncements

In October 2009, the FASB issued an amendment to its accounting guidance on revenue arrangements with multiple deliverables, which addresses the unit of accounting for arrangements involving multiple deliverables and how consideration should be allocated to separate units of accounting, when applicable. The amendment requires that arrangement considerations be allocated at the inception of the arrangement to all deliverables using the relative selling price method and provides for expanded disclosures related to such arrangements. The amendment is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is allowed. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued an amendment to the disclosure requirements for fair value measurements. The amendment requires an entity to: (i) disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers, and (ii) present separate information for Level 3 activity pertaining to gross purchases, sales, issuances and settlements. The new disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the Level 3 disclosures, which are effective for fiscal years beginning after December 15, 2010. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

In March 2010, the FASB ratified accounting guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. This guidance provides criteria that must be met to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. The amendment is effective for milestones achieved in fiscal years beginning on or after June 15, 2010. Early adoption is allowed. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

NOTE 3 — Share-Based Compensation

As indicated above, the Company recognizes compensation expense for all share-based compensation awards made to employees and directors based on estimated fair values. A summary of the Company's share-based compensation plans is presented below.

Equity Award Plans

The Company has adopted several equity award plans, all of which have been approved by the Company's shareholders that authorize the granting of options, restricted stock and other forms of equity awards of the Company's common shares subject to certain conditions. At December 31, 2010, the Company had reserved 5.2 million of its common shares for issuance of share-based compensation awards under the Company's equity award plans.

Option award plans require options to be granted at the fair value of the shares underlying the options at the date of the grant and generally become exercisable over periods ranging from three to five years and expire in ten years. In conjunction with certain of the Company's acquisitions, Watson assumed stock option and warrant plans from the acquired companies. The options and warrants in these plans were adjusted by the individual exchange ratios specified in each transaction. No additional options or warrants have been granted under any of the assumed plans.

Beginning in 2005, the Compensation Committee of the board of directors of the Company (the "Board") authorized and issued restricted stock to the Company's employees, including its executive officers and certain non-employee directors (the "Participants") under the Company's equity compensation plans. The restricted stock award program offers Participants the opportunity to earn shares of our common stock over time, rather than options that give Participants the right to purchase stock at a set price. Restricted stock awards are grants that entitle the holder to shares of common stock subject to certain terms. Restricted stock awards generally have restrictions eliminated over a one to four year period. Restrictions generally lapse for non-employee directors after one year. Restrictions generally lapse for employees over a two to four year period. The fair value of restricted stock grants is based on the fair market value of our common stock on the respective grant dates. Restricted stock compensation is being amortized and charged to operations over the same period as the restrictions are eliminated for the Participants.

Share-Based Compensation

Share-based compensation expense recognized in the Company's results of operations for the years ended December 31, 2010, 2009 and 2008 was \$23.5 million, \$19.1 million and \$18.5 million, respectively. Share-based compensation capitalized to inventory was \$3.6 million, \$2.7 million and \$3.3 million for the years ended December 31, 2010, 2009 and 2008, respectively.

NOTE 4 — Acquisitions and Divestitures

Acquisition of Arrow Group

On the Acquisition Date, Watson acquired all the outstanding equity of privately held Arrow Group for cash, stock and certain contingent consideration (the "Arrow Acquisition"). In accordance with the terms of the share purchase agreement dated June 16, 2009, as amended on November 26, 2009 (together the "Acquisition Agreement"), the Company acquired all the outstanding equity of the Arrow Group for the following consideration:

- The payment of cash and the assumption of certain liabilities totaling \$1.05 billion;
- Approximately 16.9 million restricted shares of Common Stock of Watson (the "Restricted Common Stock");

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- 200,000 shares of newly designated mandatorily redeemable, non-voting Series A Preferred Stock of Watson (the "Mandatorily Redeemable Preferred Stock") placed in escrow for the benefit of the former shareholders of the Arrow Group (the "Arrow Selling Shareholders"); and
- Certain contingent consideration based on the after-tax gross profits on sales of the authorized generic version of Lipitor® (atorvastatin) in the U.S. calculated and payable as described in the Acquisition Agreement. For additional information on the contingent payment, refer to "NOTE 10 — Other Long-Term Liabilities."

The following table presents a summary of the purchase price consideration for the Arrow Acquisition (in millions):

	<u>Amount</u>
Cash consideration	\$ 1,050.0
Fair value of Restricted Common Stock	636.2
Fair value of Mandatorily Redeemable Preferred Stock	150.0
Fair value estimate of atorvastatin contingent payment consideration (refer to "NOTE 10 — Other Long-Term Liabilities.")	110.0
	<u>\$ 1,946.2</u>

Fair Value of Consideration Transferred

In accordance with existing U.S. GAAP, the fair value of Restricted Common Stock issued as part of the consideration transferred was measured on the Acquisition Date at the then-current market price of \$37.55 per share for approximately \$636.2 million.

Mandatorily Redeemable Preferred Stock was issued in the form of zero-coupon, non-convertible preferred stock which will be redeemable in the amount of \$200.0 million, less the amount of any indemnity payments, three years after the Acquisition Date. The fair value of the Mandatorily Redeemable Preferred Stock at Acquisition Date was estimated by the Company to be \$150.0 million, based on the terms they were issued under and the cost of the Company's other fixed rate borrowings and is presented within long-term debt at its current fair value at December 31, 2010 of \$166.4 million. For additional information on the Mandatorily Redeemable Preferred Stock, refer to "NOTE 9 — Long-Term Debt."

The Company determined the acquisition date fair value of the contingent consideration obligation based on a probability-weighted income approach derived from atorvastatin revenue estimates and post-tax gross profit levels and a probability assessment with respect to the likelihood of achieving the various earn-out criteria. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows were discounted using an effective annual interest rate of 10.4%. At each reporting date, the Company adjusts the contingent consideration obligation to estimated fair value and records changes in fair value as expense in our consolidated statement of operations. Changes in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. As of December 31, 2010 the range of outcomes and the assumptions used to develop the estimates have not changed significantly from those used at Acquisition Date. Accretion expense related to the increase in the net present value of the contingent liability is included in interest expense for the period.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Divestiture of Certain Assets

In order to obtain regulatory approval under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), in connection with the Arrow Acquisition, Watson and the Arrow Group were required to divest certain assets. In conjunction with the closing, Watson sold its Abbreviated New Drug Application ("ANDA") for Cabergoline, the generic equivalent to Dostinex, to Impax Laboratories, Inc. The Arrow Group sold its pending ANDA for Dronabinol, a generic equivalent to Marinol, to Impax Laboratories, Inc.

Resolution Chemicals Ltd., the subsidiary of the Arrow Group that manufactures the Dronabinol active pharmaceutical ingredient, was divested in accordance with the terms of the consent order under the HSR Act immediately prior to the closing.

Allocation of Consideration Transferred

The transaction has been accounted for using the purchase method of accounting under existing U.S. GAAP. The purchase method under existing U.S. GAAP requires, among other things, that assets acquired and liabilities assumed in a business purchase combination be recognized at their fair values as of the acquisition date and that IPR&D be recorded at fair value on the balance sheet regardless of the likelihood of success of the related product or technology. In addition, any common stock consideration transferred is measured at acquisition date at the then current market price.

The following table summarizes the fair values of the tangible & identifiable intangible assets acquired and liabilities assumed at Acquisition Date, with the excess being allocated to goodwill. During the quarter ended June 30, 2010, management completed its allocation of intellectual properties by tax jurisdiction and the resulting deferred tax liabilities by legal entity, its evaluation of uncertain tax positions and related deferred tax assets and liabilities. These adjustments are reflected in the values presented below and in our revised December 31, 2009 balance sheet (in millions):

	<u>Amount</u>
Cash and cash equivalents	\$ 64.9
Accounts receivable	107.6
Inventories	187.9
Other current assets	174.5
Property, plant & equipment	82.4
IPR&D intangible assets	711.0
Intangible assets	518.6
Goodwill	632.9
Long-term deferred tax assets	69.6
Other assets	10.6
Current liabilities	(306.3)
Long-term deferred tax and other tax liabilities	(303.6)
Other long-term liabilities	(3.9)
Net assets acquired	<u>\$ 1,946.2</u>

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Inventories

The fair value of inventories acquired included a step-up in the value of inventories of approximately \$26.0 million. Approximately \$14.2 million was amortized to cost of sales during 2009 and the remaining \$11.8 million was amortized to cost of sales in the first quarter of 2010.

Other Current Assets

At Acquisition Date, included in other current assets was \$90.0 million related to the fair value of amounts due from Sepracor, Inc. ("Sepracor") prior to the end of 2010 (the "Sepracor Receivable") for the transfer of certain product rights and technology from the Arrow Group. The entire amount due under the Sepracor Receivable was received by December 31, 2010.

IPR&D and Intangible Assets

IPR&D intangible assets represent the value assigned to acquired R&D projects that, as of the Acquisition Date, had not established technological feasibility and had no alternative future use. The IPR&D intangible assets are capitalized and accounted for as indefinite-lived intangible assets and will be subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project and launch of the product, Watson will make a separate determination of useful life of the IPR&D intangible and amortization will be recorded as an expense over the estimated useful life.

The fair value of the IPR&D and identifiable intangible assets was determined primarily using the "income approach," which is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset would generate over its remaining useful life. Some of the more significant assumptions inherent in the development of the identifiable intangible assets valuations, from the perspective of a market participant, include the estimated net cash flows for each year for each project or product (including net revenues, cost of sales, research and development costs, selling and marketing costs and working capital/asset contributory asset charges), the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset's life cycle, competitive trends impacting the asset and each cash flow stream as well as other factors. The discount rate used to arrive at the present value of IPR&D projects as of the Acquisition Date was approximately 10.4% to reflect the internal rate of return and incremental commercial uncertainty in the projections as the products have not yet received regulatory approval. The major risks and uncertainties associated with the timely and successful completion of the IPR&D projects include legal risk and regulatory risk. No assurances can be given that the underlying assumptions used to prepare the discounted cash flow analysis will not change or the timely completion of each project to commercial success will occur. For these and other reasons, actual results may vary significantly from estimated results.

Intangible assets represent the Arrow Group's CMP and have an estimated weighted average useful life of five years.

Goodwill Allocation

Among the primary reasons the Company entered into the Arrow Acquisition and factors that contributed to a purchase price allocation resulting in the recognition of goodwill were a history of operating margins and profitability, a strong R&D department and several first-to file opportunities, expanded commercial footprint on a global basis and key pipeline additions, including atorvastatin and budesonide which will enable Watson to expand its product offerings and offer its customers a greater breadth of product offerings. The goodwill recognized from the Arrow Acquisition is not deductible for tax purposes. All goodwill from the Arrow Acquisition was assigned to the Global Generics segment.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Long-Term Deferred Tax Liabilities and Other Tax Liabilities

Long-term deferred tax liabilities and other tax liabilities reflects a deferred income tax liability representing the impact of purchase accounting adjustments for the inventory fair value step-up, property, plant and equipment fair value adjustment, contingencies adjustment and identifiable IPR&D and intangible assets fair value adjustment. This determination of deferred tax liabilities was based on the excess book basis over the tax basis resulting from the above fair value adjustments using the statutory tax rate for each country these fair value adjustments were assigned.

Acquisition-Related Expenses

Included in general and administrative expenses in the consolidated statement of operations for the year ended December 31, 2009 were pretax charges totaling \$16.6 million for advisory, legal and regulatory costs in connection with the Arrow Acquisition.

Unaudited Pro Forma Results of Operations

The following table presents the unaudited pro forma operating results for the Company, assuming the Arrow Acquisition had occurred as of the beginning of each period presented. The unaudited pro forma results reflect certain adjustments related to the acquisition, such as increased depreciation and amortization expense on the fair valuation of assets acquired, the impact of acquisition financing in place at December 31, 2009 and the related tax effects. The pro forma results do not include any anticipated synergies which may be achievable subsequent to the Acquisition Date. Accordingly, such pro forma amounts are not necessarily indicative of the results that actually would have occurred had the acquisition been completed on the dates indicated, nor are they indicative of the future operating results of the combined company.

	Year Ended December 31,	
	2009	2008
	(In millions, except per share amounts)	
Net revenues	\$ 3,261.9	\$ 3,170.6
Net income	119.3	281.5
Earnings per share:		
Basic	0.99	2.35
Diluted	0.98	2.34

Acquisition of Crinone® and Prochieve® Assets from Columbia Laboratories, Inc. ("Columbia")

On July 2, 2010, the Company completed the acquisition of the U.S. rights to Columbia products Crinone® and Prochieve® and acquired 11.2 million shares of Columbia's common stock, representing approximately a 13% ownership share, for initial cash consideration of \$62.0 million and certain contingent consideration of up to an additional \$45.5 million based upon the successful completion of certain milestones and regulatory approvals.

The transaction was accounted for using the purchase method of accounting under existing U.S. GAAP with assets acquired and liabilities assumed recorded at their fair values as of the acquisition date. The purchase price for the Columbia acquisition was allocated to tangible and identifiable intangible assets

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

acquired and liabilities assumed based on their estimated fair values at the acquisition date as follows (in millions):

	Amount
Investments	\$ 11.5
IPR&D intangible assets	75.8
Intangible assets	39.5
Long-term deferred tax assets	24.3
Contingent consideration obligations	(64.8)
Long-term deferred tax liabilities	(24.3)
Net assets acquired	\$ 62.0

Pro forma results of operations have not been presented because the effect of the acquisition was not material.

Acquisition of Equity Interest in Moksha8 Pharmaceuticals, Inc. ("Moksha8")

On October 4, 2010, the Company entered into an agreement with Moksha8 to expand into markets in Brazil and Mexico. The Company made an initial investment of \$30.0 million in cash in Moksha8 in exchange for an approximate 22% ownership share in Moksha8. The Company is also committed to invest an additional \$20.0 million in Moksha8 contingent upon the successful execution by Moksha8 of additional third-party product acquisitions over the next year which will increase our ownership share to approximately 31%.

Sale of Scinopharm Taiwan Ltd. ("Scinopharm")

On March 24, 2010, all closing conditions were satisfied in our agreement with Uni-President Enterprises Corporation to sell our outstanding shares of Scinopharm. Under the terms of the stock purchase agreement, we sold our entire holdings of common shares for net proceeds of approximately \$94.0 million resulting in a gain on sale of securities in the amount of \$23.4 million.

NOTE 5 — Other Income

Other income consisted of the following (in millions):

	Years Ended December 31,		
	2010	2009	2008
Gain (loss) on sale of securities	\$ 25.6	\$ (1.1)	\$ 9.6
Earnings on equity method investments	1.6	10.8	10.6
Loss on early extinguishment of debt	(0.5)	(2.0)	(1.1)
Other income	1.0	0.2	0.2
	\$ 27.7	\$ 7.9	\$ 19.3

In March 2010, we completed the sale of our outstanding shares of Scinopharm for net proceeds of approximately \$94.0 million. The earnings on equity investments for the year ended December 31, 2009 were higher than the current year due to the sale of our outstanding shares of Scinopharm during the first quarter of 2010.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

NOTE 6 — Balance Sheet Components

Selected balance sheet components consisted of the following (in millions):

	December 31,	
	2010	2009 (Revised)
Inventories:		
Raw materials	\$ 178.4	\$ 196.8
Work-in-process	38.4	64.1
Finished goods	465.6	509.1
	682.4	770.0
Less: Inventory reserves	51.4	77.7
Inventories, net	<u>\$ 631.0</u>	<u>\$ 692.3</u>
Property and equipment:		
Machinery and equipment	\$ 570.4	\$ 525.0
Buildings and improvements	385.7	382.4
Research and laboratory equipment	106.9	94.9
Leasehold improvements	90.0	78.5
Furniture and fixtures	46.2	45.1
Land and land improvements	33.9	31.9
Construction in progress	32.5	39.6
Total property and equipment, at cost	1,265.6	1,197.4
Less accumulated depreciation	(623.3)	(503.2)
Total property and equipment, net	<u>\$ 642.3</u>	<u>\$ 694.2</u>
Accounts payable and accrued expenses:		
Trade accounts payable	\$ 215.2	\$ 263.1
Proposed legal settlements	129.9	20.6
Accrued payroll and related benefits	88.7	82.1
Accrued third-party rebates	83.0	60.2
Royalties and sales agent payables	35.5	36.8
Current portion of contingent consideration obligations	28.9	—
Accrued indirect returns	23.5	23.5
Interest payable	17.6	16.9
Accrued severance, retention and other shutdown costs	20.0	15.9
Other accrued expenses	98.8	95.2
Total accounts payable and accrued expenses	<u>\$ 741.1</u>	<u>\$ 614.3</u>

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

NOTE 7 — Investments in Marketable Securities and Other Investments

	December 31,	
	2010	2009
	(In millions)	
Marketable securities:		
U.S. Treasury and agency securities — maturing within one year	\$ 4.8	\$ 6.0
U.S. Treasury and agency securities — maturing within two years	5.5	6.3
Equity securities	0.8	1.3
Total marketable securities	\$ 11.1	\$ 13.6
Investments and other assets:		
Equity method investments	\$ 63.2	\$ 75.4
Cost method and other long-term investments	0.3	9.4
Other assets	21.0	29.7
Total investments and other assets	\$ 84.5	\$ 114.5

Watson's marketable securities and other long-term investments are classified as available-for-sale and are recorded at fair value based on quoted market prices using the specific identification method. These investments are classified as either current or non-current, as appropriate, in the Company's Consolidated Balance Sheets.

The following table provides a summary of the fair value and unrealized gains (losses) related to Watson's available-for-sale securities (in millions):

At December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury and agency securities	\$ 10.3	\$ —	\$ —	\$ 10.3
Equity securities — current	—	0.8	—	0.8
Current	10.3	0.8	—	11.1
Equity securities — non-current	—	0.1	—	0.1
Total	\$ 10.3	\$ 0.9	\$ —	\$ 11.2

At December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury and agency securities	\$ 12.3	\$ —	\$ —	\$ 12.3
Equity securities — current	0.7	0.6	—	1.3
Current	13.0	0.6	—	13.6
Equity securities — non-current	0.1	2.9	—	3.0
Total	\$ 13.1	\$ 3.5	\$ —	\$ 16.6

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Current Investments

The Company invests in U.S. Treasury and agency securities. These investments are included in marketable securities on the Company's Consolidated Balance Sheets at December 31, 2010 and 2009. Current investments are classified as available-for-sale and are recorded at fair value based on quoted market prices.

Investment in Equity Method Investments

The Company's investments in equity method investments at December 31, 2010 consist of its investments in Columbia and Moksha8 and certain equity method investments in privately held companies acquired as part of Arrow Acquisition. (Refer to "NOTE 4 — Acquisition and Divestitures" for additional information on Columbia and Moksha8.)

On March 24, 2010, the Company sold its entire holdings of common shares in the equity of Scinopharm to Uni-President Enterprises Corporation. (Refer to "NOTE 4 — Acquisition and Divestitures" for additional information on Scinopharm).

The Company recorded net earnings from equity method investments of \$1.6 million in 2010, \$10.8 million in 2009 and \$10.6 million in 2008, respectively.

The Company is not required to provide ongoing investments or additional funding to its joint ventures with the exception of a commitment to invest an additional \$20.0 million in Moksha8 upon Moksha8 meeting certain conditions. (Refer to "NOTE 4 — Acquisition and Divestitures" for additional information on Moksha8.)

Cost Method Investments

The Company's cost method investments consist primarily of investments in common shares of a number of private and public companies where our ownership interest is under 20% or where we do not have the ability to exercise significant influence.

Other Assets

Other assets include security and equipment deposits and deferred financing fees, net of amortization.

NOTE 8 — Goodwill, Product Rights and Other Intangibles

Goodwill for the Company's reporting units consisted of the following:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
		<u>(Revised)</u>
	(In millions)	
Global Brands segment	\$ 371.6	\$ 348.2
Global Generics segment	1,070.2	1,066.5
Distribution segment	86.3	86.3
Total goodwill	<u>\$ 1,528.1</u>	<u>\$ 1,501.0</u>

The increase in goodwill in 2010 primarily relates to the acquisition of the remaining 64% of Eden as discussed in "NOTE 1 — Description of Business". Goodwill for the Company's Global Generics segment as of December 31, 2009 has been revised from the amount presented in our Annual report on Form 10-K for the year ended December 31, 2009. (Refer to "NOTE 4 — Acquisitions and Divestitures" for additional details.)

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Other intangible assets consist primarily of product rights. The original cost and accumulated amortization of these intangible assets, where applicable, consisted of the following:

	December 31,	
	2010	2009
	(In millions)	
Intangibles with definite lives		
Product rights and other related intangibles	\$ 2,049.7	\$ 1,855.8
Core technology	52.5	52.5
Customer relationships	49.1	49.1
	2,151.3	1,957.4
Less accumulated amortization	(1,211.1)	(1,031.1)
	940.2	926.3
Intangibles with indefinite lives		
IPR&D	615.6	711.0
Trade Name	76.2	76.2
	691.8	787.2
Total product rights and related intangibles, net	\$ 1,632.0	\$ 1,713.5

Intangible assets acquired with the Arrow Acquisition amounted to \$1,119.6 million, including \$518.6 million relating to CMP and \$711.0 million relating to IPR&D intangibles. CMP intangibles have been included in product rights and other related intangibles and will be amortized over a weighted average useful life of approximately five years.

In July 2010, the Company acquired intangible assets in connection with the acquisition of the U.S rights to certain Columbia products amounting to \$115.3 million, including \$39.5 million relating to CMP and \$75.8 million relating to IPR&D intangibles. CMP intangibles have been included in product rights and other related intangibles and will be amortized using a weighted average useful life of approximately five years.

During 2010 approximately \$142.3 million of IPR&D intangibles were transferred to product rights and other related intangibles as products received regulatory approval. Amortization of these intangibles commenced upon product launch using a weighted average useful life of approximately five years.

Watson re-evaluates the carrying value of identifiable intangible and long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company continually evaluates the appropriateness of useful lives assigned to long-lived assets, including product rights.

During the fourth quarter of 2010, the Company recorded a \$28.6 million impairment charge related to certain IPR&D assets acquired in the Arrow Acquisition. The impairment charge results from the Company's current estimate of the fair value of these IPR&D assets, based on updated forecasts, compared to their assigned fair values on Acquisition Date. The fair value of acquired identifiable intangible assets generally is determined using an income approach, based on a forecast of all expected future net cash flows related to the asset which are adjusted to present value using appropriate discount rates. Forecasts used to determine fair values of IPR&D assets are based on appropriate assumptions which include, among other factors, the impact of changes to the development programs, the current competitive environment, the regulatory timeframes impacting future product launch dates and the risk associated with these assets.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Assuming no additions, disposals or adjustments are made to the carrying values and/or useful lives of the assets, annual amortization expense on product rights and related over the next five years is estimated to be as follows (in millions):

	Amount
2011	\$ 270.0
2012	417.5
2013	311.5
2014	299.3
2015	138.6

The above amortization expense is an estimate. Actual amounts may change from such estimated amounts due to fluctuations in foreign currency exchange rates, additional intangible asset acquisitions, potential impairments, accelerated amortization or other events. The Company's current product rights and related intangibles have a weighted average remaining useful life of approximately five years.

NOTE 9 — Long-Term Debt

Long-term debt consisted of the following:

	December 31,	
	2010	2009
(In millions)		
Senior Notes,		
2014 Notes	\$ 450.0	\$ 450.0
2019 Notes	400.0	400.0
	850.0	850.0
Less: Unamortized discount	(2.1)	(2.5)
Senior Notes, net	847.9	847.5
2006 Credit Facility	—	400.0
Mandatorily Redeemable Preferred Stock	166.4	151.2
Loan with Lombard Odier Darier Hentsch & Cie. ("Lombard Loan")	—	55.0
Other notes payable	1.8	4.1
	1,016.1	1,457.8
Less: Current portion	—	307.6
Total long-term debt	<u>\$ 1,016.1</u>	<u>\$ 1,150.2</u>

Senior Notes

The offering of \$450.0 million of 2014 Notes and \$400.0 million of 2019 Notes was registered under an "automatic shelf" registration statement filed with the Securities and Exchange Commission ("SEC"). The Senior Notes were issued pursuant to a senior note indenture dated as of August 24, 2009 between the Company and Wells Fargo Bank, National Association, as trustee, as supplemented by a first supplemental indenture dated August 24, 2009 (together the "Senior Note Indentures").

Interest payments are due on the Senior Notes semi-annually in arrears on February 15 and August 15, respectively, beginning February 15, 2010 at an effective annual interest rate of 5.43% on the 2014 Notes and 6.35% on the 2019 Notes.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company may redeem the Senior Notes on at least 15 days but no more than 60 days prior written notice for cash for a redemption price equal to the greater of 100% of the principal amount of the Senior Notes to be redeemed and the sum of the present values of the remaining scheduled payments, as defined by the Senior Note Indentures, of the Senior Notes to be redeemed, discounted to the date of redemption at the applicable treasury rate, as defined by the Senior Note Indentures, plus 40 basis points. As of December 31, 2010, the fair value of our Senior Notes was approximately \$71.0 million greater than the carrying value.

Upon a change of control triggering event, as defined by the Senior Note Indentures, the Company is required to make an offer to repurchase the Senior Notes for cash at a repurchase price equal to 101% of the principal amount of the Senior Notes to be repurchased plus accrued and unpaid interest to the date of purchase.

Net proceeds from the offering of Senior Notes in 2009 were used to repay certain amounts under the 2006 Credit Facility and to redeem other debt with the remaining net proceeds being used to fund a portion of the cash consideration for the Arrow Acquisition.

2006 Credit Facility

In November 2006, the Company entered into the 2006 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 provides an aggregate of \$1.15 billion of senior financing to Watson, consisting of a \$500.0 million revolving credit facility ("Revolving Facility") and a \$650.0 million senior term loan facility ("Term Facility") and an initial interest rate equal to LIBOR plus 0.75% (subject to certain adjustments). In July 2010, the interest rate on the 2006 Credit Facility was reduced to LIBOR plus 0.625%.

The 2006 Credit Facility has a five-year term and matures in November 2011. The indebtedness under the 2006 Credit Facility is guaranteed by Watson's material domestic subsidiaries, other than minor subsidiaries, on a joint and several basis. The Revolving Facility is available for working capital and other general corporate requirements subject to the satisfaction of certain conditions. During 2010, the Company repaid \$400.0 million on the 2006 Credit Facility. As of December 31, 2010, no amounts were outstanding on either the Revolving Facility or the Term Facility of the 2006 Credit Facility.

The Company is subject to, and, as of December 31, 2010, was in compliance with, all financial and operation covenants under the terms of the 2006 Credit Facility.

Mandatorily Redeemable Preferred Stock

In connection with the Arrow Acquisition, on December 2, 2009, pursuant to the Purchase Agreement, Watson issued 0.2 million shares of newly designed non-voting Series A Preferred Stock of Watson, having a stated value of \$1,000 per share (the "Stated Value"), or an aggregate stated value of \$200.0 million, which have been placed in an indemnity escrow account for a period of three years.

The provisions for the Mandatorily Redeemable Preferred Stock are as follows:

Dividends

The holders of Mandatorily Redeemable Preferred Stock shall be entitled to receive dividends, when and of declared by the board of directors.

Liquidation Preference

In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Company, the holders of the Mandatorily Redeemable Preferred Stock will be paid out of the assets of Watson available for

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

distribution to Watson's shareholders before any payment shall be paid to the holders of Watson's common stock, an amount equal to the Stated Value of the Mandatorily Redeemable Preferred Stock.

Mandatory Redemption

Each share of Mandatorily Redeemable Preferred Stock is mandatorily redeemable by Watson in cash on December 2, 2012, the third anniversary of its issuance at the Stated Value.

Change in Control Redemption

Upon occurrence of a Change in Control event (as defined in the Certificate of Designations of the Mandatorily Redeemable Preferred Stock that was previously filed with the SEC on December 2, 2009), Watson shall have the right to redeem all of the outstanding Mandatorily Redeemable Preferred Stock in cash for a price per share equal to the Stated Value.

Voting Rights

The holders of the Mandatorily Redeemable Preferred Stock are not entitled to vote on any matters presented to the shareholders of Watson for their actions or consideration at any meetings of the shareholders of Watson (or by written consent of shareholders in lieu of the meetings), except that the written consent or affirmative vote of at least two thirds of the then outstanding shares of Mandatorily Redeemable Preferred Stock consenting or voting separately as a class is required on any matters that would amend, alter or repeal any terms, preferences, special rights or powers of the Mandatorily Redeemable Preferred Stock. The holders of the Mandatorily Redeemable Preferred Stock may also vote on any matters required by law.

In accordance with the existing U.S. GAAP, the Mandatorily Redeemable Preferred Stock has been reported as long-term debt and accretion expense has been classified as interest expense. The fair value of the Mandatorily Redeemable Preferred Stock was estimated to be \$150.0 million at Acquisition Date based on the mandatory redemption value of \$200.0 million on December 2, 2012 using a discount rate of 9.63% per annum. At December 31, 2010, the fair value of the Mandatorily Redeemable Preferred Stock was \$166.4 million and the unamortized accretion expense was \$33.6 million.

Lombard Loan

On November 25, 2009, prior to closing the Arrow Acquisition, the Arrow Group received loan proceeds from Lombard Odier Darier Hentsch & Cie. in the amount of \$90.0 million.

In accordance with the terms of the Lombard Loan, \$35.0 million was paid in December 2009 and the remaining balance of \$55.0 million was paid in 2010.

Fair Value of Outstanding Debt

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 December 31, 2010. As of December 31, 2010, the fair value of our Senior Notes was \$71.0 million greater 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.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Annual Debt Maturities

At December 31, 2010, annual maturities of long-term debt were as follows (in millions):

	Amount
2011	\$ 0.1
2012	200.1
2013	0.1
2014	450.1
2015	1.4
Thereafter	400.0

Amounts represent total anticipated cash payments on our Senior Notes, Mandatorily Redeemable Preferred Stock and other current and long-term debt assuming existing debt maturity schedules. Any early settlement of our Senior Notes through redemption or repurchase privileges, as defined under the terms of the Senior Notes, would change the timing of principal amounts due under the Company's long-term debt obligations.

NOTE 10 — Other Long-Term Liabilities

Other long-term liabilities consisted of the following:

	December 31,	
	2010	2009
	(In millions)	
Atorvastatin contingent consideration liability	\$ 123.1	\$ 111.0
Columbia contingent consideration liability	75.4	—
Other long-term liabilities	13.5	7.7
	212.0	118.7
Less: Current portion included in accounts payable and accrued expenses	28.9	—
Total other long-term liabilities	<u>\$ 183.1</u>	<u>\$ 118.7</u>

The Company determines the acquisition date fair value of contingent consideration obligations based on a probability-weighted income approach derived from revenue estimates and a probability assessment with respect to the likelihood of achieving contingent obligations including contingent payments such as milestone obligations, royalty obligations and contract earn-out criteria, where applicable. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The resultant probability-weighted cash flows are discounted using an appropriate effective annual interest rate to reflect the internal rate of return and incremental commercial uncertainty, major risks and uncertainties associated with the successful completion of the projects triggering the contingent obligation. At each reporting date, the Company will revalue the contingent consideration obligation to estimated fair value and record changes in fair value as income or expense in our consolidated statement of operations. Changes in the fair value of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of revenue estimates and changes in probability assumptions with respect to the likelihood of achieving the various contingent consideration obligations. Accretion expense related to the increase in the net present value of the contingent liability is included in interest expense for the period.

Atorvastatin Contingent Consideration Liability

In accordance with the Acquisition Agreement, the Arrow Selling Shareholders will have the right to receive certain contingent payments based on the after-tax gross profits on sales of atorvastatin within the

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

U.S. (the "Territory") from product launch date up to and including May 31, 2013 (the "Contingent Payment Period"). The determination of contingent payment amounts is dependent upon the existence of generic competition within the Territory and post-tax gross profits earned, as defined in the Acquisition Agreement. Should there be no competing generic product launched in the Territory during the Contingent Payment Period, payment of contingent consideration will be calculated as 50% of the post-tax gross profits, as defined in the Acquisition Agreement. Should there be a competing product to atorvastatin launched in the Territory during the Contingent Payment Period, the contingent consideration will be calculated as either 85% of the post-tax gross profits or 15% of the post-tax gross profits, as defined in the Acquisition Agreement, with total contingent payments being limited to \$250.0 million during the Contingent Payment Period.

As of December 31, 2010 the range of outcomes and the assumptions used to develop the estimates have not changed significantly from those used at Acquisition Date. Other long-term liabilities at December 31, 2010 and 2009 includes the fair value of the atorvastatin contingent liability of \$123.1 million and \$111.0 million, respectively.

Columbia Contingent Consideration Liability

On July 2, 2010, the Company completed the acquisition of the U.S. rights to Columbia products Crinone[®] and Prochieve[®] for initial cash consideration of \$62.0 million and acquired certain assets and assumed certain contingent consideration obligations. The transaction was accounted for using the purchase method of accounting under existing U.S. GAAP with assets acquired and liabilities assumed recorded at their fair values as of the acquisition date. The purchase price for the Columbia acquisition was allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. Fair value determinations of Columbia's contingent payment obligations on acquisition date were based on, among other factors, estimates of expected future cash flows, estimates of appropriate discount rates used to present value expected future cash flow streams, the timing of approvals for IPR&D projects and the timing of related product launch dates and other factors. Contingent consideration obligations primarily relate to anticipated future milestone payments and royalty payments due to Columbia in accordance with the terms of the Columbia acquisition agreement.

Other long-term liabilities at December 31, 2010 include the fair value of the Columbia contingent consideration liability of \$46.5 million (which excludes the current amount of \$28.9 million presented within accounts payable and current liabilities).

NOTE 11 — Income Taxes

The Company's income before provision for income taxes was generated from the United States and international operations as follows:

	Years Ended December 31,		
	2010	2009	2008
	(In millions)		
Income before income taxes:			
U.S.	\$ 391.6	\$ 366.5	\$ 353.2
Foreign	(141.0)	(3.9)	5.1
Income before income taxes	\$ 250.6	\$ 362.6	\$ 358.3

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's provision for income taxes consisted of the following:

	Years Ended December 31,		
	2010	2009	2008
	(In millions)		
Current provision:			
Federal	\$ 161.4	\$ 133.0	\$ 101.3
State	14.9	20.2	14.3
Foreign	9.3	6.4	0.8
Total current provision	<u>185.6</u>	<u>159.6</u>	<u>116.4</u>
Deferred (benefit) provision:			
Federal	(54.1)	(7.8)	3.1
State	(10.2)	(5.5)	0.4
Foreign	(54.0)	(5.7)	—
Total deferred (benefit) provision	<u>(118.3)</u>	<u>(19.0)</u>	<u>3.5</u>
Total provision for income taxes	<u>\$ 67.3</u>	<u>\$ 140.6</u>	<u>\$ 119.9</u>

The exercise of certain stock options resulted in a tax benefit and has been reflected as a reduction of income taxes payable and an increase to additional paid-in capital. Such benefits recorded were \$6.7 million, \$2.3 million, and \$0.2 million for the years ended December 31, 2010, 2009, and 2008, respectively.

Reconciliations between the statutory federal income tax rate and the Company's effective income tax rate were as follows:

	2010	2009	2008
Federal income tax at statutory rates	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	1.6%	2.9%	2.6%
Foreign rate differential	(0.8)%	(0.1)%	0.0%
Non-deductible expenses	5.7%	0.8%	0.3%
R&D credit and U.S. manufacturing deduction	(3.7)%	(1.7)%	(1.0)%
Charitable contributions	(1.0)%	(0.1)%	(0.5)%
Favorable tax audit outcomes	(7.8)%	0.0%	(1.6)%
Valuation allowance	(1.4)%	(0.5)%	(0.7)%
Transaction costs	0.0%	1.6%	0.0%
Sale of subsidiary	(2.1)%	0.0%	(1.1)%
Other	1.4%	0.9%	0.5%
Effective income tax rate	<u>26.9%</u>	<u>38.8%</u>	<u>33.5%</u>

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Deferred tax assets and liabilities are measured based on the difference between the financial statement and tax basis of assets and liabilities at the applicable tax rates. The significant components of the Company's net deferred tax assets (liabilities) consisted of the following:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
	(In millions)	
Benefits from net operating loss and tax credit carryforwards	\$ 94.2	\$ 86.9
Differences in financial statement and tax accounting for:		
Inventories, receivables and accruals	145.6	101.6
Property, equipment and intangible assets	(305.7)	(366.1)
Deferred revenue	12.9	12.1
Deferred interest expense	(76.3)	(76.3)
Share-based compensation	12.8	10.5
Other	4.3	14.4
Total deferred tax liability, gross	(112.2)	(216.9)
Less: Valuation allowance	(29.7)	(28.4)
Total deferred tax liability, net	<u>\$ (141.9)</u>	<u>\$ (245.3)</u>

The Company had the following carryforward tax attributes at December 31, 2010:

- \$197.0 million state tax net operating losses ("NOLs") which begin to expire in 2011;
- \$96.0 million foreign tax NOLs which begin to expire in 2011; and
- Tax credits of \$36.0 million in foreign jurisdictions which are not subject to expiration.

A valuation allowance has been established due to the uncertainty of realizing certain net operating losses, tax credits and deferred tax assets relating to some impaired investments.

Deferred income taxes have not been provided on the undistributed earnings of certain of the Company's foreign subsidiaries of approximately \$89.3 million and \$36.1 million as of December 31, 2010 and 2009, respectively. These amounts have been indefinitely reinvested. It is not practicable to calculate the deferred taxes associated with these earnings; however, foreign tax credits would likely be available to reduce federal income taxes in the event of distribution.

Accounting for Uncertainty in Income Taxes

At December 31, 2010, 2009 and 2008, the liability for income tax associated with uncertain tax positions was \$68.0 million, \$72.2 million and \$61.3 million, respectively. As of December 31, 2010, the net amount of

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

\$60.2 million, if recognized, would favorably affect the Company's effective tax rate. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	December 31,		
	2010	2009	2008
	(In millions)		
Balance at the beginning of the year	\$ 72.2	\$ 61.3	\$ 71.2
Increases for current year tax positions	5.9	6.9	5.0
Increases for prior year tax positions	20.1	12.7	7.8
Decreases for prior year tax positions	(27.5)	(3.9)	(11.9)
Settlements	(2.3)	(4.4)	(10.8)
Lapse of applicable statute of limitations	(0.4)	(0.4)	—
Balance at the end of the year	<u>\$ 68.0</u>	<u>\$ 72.2</u>	<u>\$ 61.3</u>

The Company's continuing practice is to recognize interest and penalties related to uncertain tax positions in tax expense. During the years ended December 31, 2010, 2009 and 2008, the company recognized approximately (\$2.3) million, \$1.4 million and (\$0.8) million in interest and penalties, respectively. At December 31, 2010, 2009 and 2008 the Company had accrued \$2.4 million (net of tax benefit of \$1.8 million), \$5.1 million (net of tax benefit of \$3.1 million), and \$3.9 million (net of tax benefit of \$2.3 million) of interest and penalties related to uncertain tax positions, respectively.

The Company conducts business globally and, as a result, it files federal, state and foreign tax returns. The Company strives to resolve open matters with each tax authority at the examination level and could reach agreement with a tax authority at any time. While the Company has accrued for amounts it believes are the probable outcomes, the final outcome with a tax authority may result in a tax liability that is more or less than that reflected in the consolidated financial statements. Furthermore, the Company may later decide to challenge any assessments, if made, and may exercise its right to appeal. The uncertain tax positions are reviewed quarterly and adjusted as events occur that affect potential liabilities for additional taxes, such as lapsing of applicable statutes of limitations, proposed assessments by tax authorities, negotiations with or between tax authorities and issuance of new legislation, regulations, rulings or case law. Management believes that adequate amounts of tax and related penalty and interest have been provided for any adjustments that may result from these uncertain tax positions.

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 2003. During the third quarter of 2010, the Internal Revenue Service ("IRS") completed its examination of the Andrx Corporation's tax returns for the pre-acquisition period and the Joint Committee of Taxation completed its review of the Company's tax returns for the 2004-2006 periods. As a result, the Company recorded a reduction to its income tax expense of \$4.7 million relating to the completion of the Andrx examination and \$13.9 million relating to the Company's examination.

In the fourth quarter of 2010, the IRS began examining the Company's 2007, 2008, and 2009 tax years. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company has accrued for amounts it believes are the probable outcomes. As a result of the ongoing IRS exam, the potential completion and/or settlement of other examinations in state and foreign jurisdictions, and the future completion of the Company's assessment of the uncertain tax positions of the Arrow Group, the quantification of all those potential changes cannot be estimated at this time.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

NOTE 12 — Stockholders' Equity

Preferred stock

In 1992, the Company authorized 2.5 million shares of no par preferred stock. The Board has the authority to fix the rights, preferences, privileges and restrictions, including but not limited to, dividend rates, conversion and voting rights, terms and prices of redemptions and liquidation preferences without vote or action by the stockholders. On December 2, 2009 the Company issued 0.2 million shares of Mandatorily Redeemable Preferred Stock. The Mandatorily Redeemable Preferred Stock is redeemable in cash on December 2, 2012 and is accordingly, included within long-term debt in the consolidated balance sheet at December 31, 2010 (for additional information on the Mandatorily Redeemable Preferred Stock refer to "NOTE 9 — Long-Term Debt").

Stock option plans

The Company has adopted several stock option plans, all of which have been approved by the Company's shareholders that authorize the granting of options to purchase the Company's common shares subject to certain conditions. At December 31, 2010, the Company had reserved 5.2 million of its common shares for issuance upon exercise of options granted or to be granted under these plans and for restricted stock grants (see discussion below). The option award plans require options to be granted at the fair value of the shares underlying the options at the date of the grant and generally become exercisable over periods ranging from three to five years and expire in ten years. In conjunction with certain of the Company's acquisitions, Watson assumed stock option and warrant plans from the acquired companies. The options and warrants in these plans were adjusted by the individual exchange ratios specified in each transaction. No additional options or warrants will be granted under any of the assumed plans.

A summary of the Company's stock option plans consisted of the following (options and aggregate intrinsic value in millions):

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding, December 31, 2009	5.3	\$ 36.91		
Granted	—	—		
Exercised	(1.7)	33.30		
Cancelled	(0.5)	49.49		
Outstanding, December 31, 2010	<u>3.1</u>	<u>\$ 36.63</u>	<u>3.2</u>	<u>\$ 48.6</u>
Vested and expected to vest at December 31, 2010	<u>3.0</u>	<u>\$ 36.71</u>	<u>3.1</u>	<u>\$ 47.6</u>
Options exercisable at December 31, 2010	<u>2.8</u>	<u>\$ 37.30</u>	<u>2.8</u>	<u>\$ 42.0</u>

As of December 31, 2010, the Company had \$0.5 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 1.1 years. Total intrinsic value of options exercised for the year ended December 31, 2010 and 2009 was \$18.4 million and \$7.4 million, respectively.

Restricted Stock Plan

Beginning in 2005, the Compensation Committee of the Board authorized and issued restricted stock to the Company's Participants under the Company's equity compensation plans. The restricted stock award program offers Participants the opportunity to earn shares of our common stock over time, rather than options that give Participants the right to purchase stock at a set price. Restricted stock awards are grants that entitle

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

the holder to shares of common stock subject to certain terms. Watson's restricted stock awards generally have restrictions eliminated over a one- to four-year period. Restrictions generally lapse for non-employee directors after one year. Restrictions generally lapse for employees over a two- to four-year period. The fair value of restricted stock grants is based on the fair market value of our common stock on the respective grant dates. Restricted stock compensation is being amortized and charged to operations over the same period as the restrictions are eliminated for the Participants.

A summary of the changes in restricted stock grants during the year ended December 31, 2010 is presented below (shares and aggregate intrinsic value in millions):

	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Restricted shares outstanding at December 31, 2009	1.9	\$ 28.79	1.7	\$ 55.7
Granted	1.0	41.03		43.7
Vested	(0.4)	27.74		(12.9)
Cancelled	(0.2)	31.55		(6.9)
Restricted shares outstanding at December 31, 2010	<u>2.3</u>	<u>\$ 34.33</u>	<u>1.6</u>	<u>\$ 79.6</u>

As of December 31, 2010, the Company had \$28.6 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 1.6 years.

Stock Repurchases

During the years ended December 31, 2010 and 2009, the Company repurchased approximately 0.1 million and 0.1 million shares, respectively, of its common stock surrendered to the Company to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees for total consideration of \$6.3 million and \$3.6 million, respectively.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) at December 31, 2010 consists of unrealized gains on securities of \$9.2 million and foreign currency translation adjustments of (\$11.7) million.

NOTE 13 — Reportable Segments

Watson has three reportable segments: Global Generics, Global Brands and Distribution. The Global Generics segment includes off-patent pharmaceutical products that are therapeutically equivalent to proprietary products. The Global Brands segment includes patent-protected products and certain trademarked off-patent products that Watson sells and markets as brand pharmaceutical products. 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 by Anda of products developed, acquired, or licensed by Watson's Global Generics and Global Brands segments. Arrow operating results are included in the Global Generics segment subsequent to the date of acquisition except for operating results from Eden which are included in our Global Brands segment.

The accounting policies of the operating segments are the same as those described in "NOTE 2 — Summary of Significant Accounting Policies." The other revenue classification consists primarily of milestone payments,

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

commission revenue, royalties and revenues from research, development and licensing fees and also includes co-promotion revenue and revenue (including the amortization of deferred revenue) relating to our obligation to manufacture and supply products to third parties. The Company evaluates segment performance based on segment contribution. Segment contribution represents segment net revenues less cost of sales (excludes amortization), direct R&D expenses and selling and marketing expenses. The Company does not report total assets, capital expenditures, corporate general and administrative expenses, amortization, gains on disposal or impairment losses by segment as such information has not been used by management, or has not been accounted for at the segment level.

Segment net revenues, segment operating expenses and segment contribution information for the Company's Global Generics, Global Brands and Distribution segments consisted of the following:

	Years Ended December 31,		
	2010	2009 (In millions)	2008
Global Generics Segment			
Product sales	\$ 2,268.9	\$ 1,641.8	\$ 1,404.0
Other revenue	69.5	26.4	70.3
Net revenues	2,338.4	1,668.2	1,474.3
Operating expenses:			
Cost of sales(1)	1,198.9	947.1	883.8
Research and development	194.6	140.4	119.2
Selling and marketing	111.9	53.8	55.2
Global Generics Contribution	\$ 833.0	\$ 526.9	\$ 416.1
Contribution margin	35.6%	31.6%	28.2%
Global Brands Segment			
Product sales	\$ 316.3	\$ 393.7	\$ 397.0
Other revenue	81.5	67.3	58.0
Net revenues	397.8	461.0	455.0
Operating expenses:			
Cost of sales(1)	88.4	89.3	107.1
Research and development	101.5	56.9	50.9
Selling and marketing	137.8	144.5	118.2
Global Brands Contribution	\$ 70.1	\$ 170.3	\$ 178.8
Contribution margin	17.6%	36.9%	39.3%
Distribution Segment			
Product sales	\$ 830.7	\$ 663.8	\$ 606.2
Other revenue	—	—	—
Net revenues	830.7	663.8	606.2
Operating expenses:			
Cost of sales(1)	711.2	560.4	511.9
Research and development	—	—	—
Selling and marketing	70.3	64.8	59.5
Distribution Contribution	\$ 49.2	\$ 38.6	\$ 34.8
Contribution margin	5.9%	5.8%	5.7%
Total Segment Contribution	\$ 952.3	\$ 735.8	\$ 629.7
Corporate general and administrative	436.1	257.1	190.5
Amortization	180.0	92.6	80.7
Loss on asset sales and impairments	30.8	2.2	0.3
Operating income	<u>\$ 305.4</u>	<u>\$ 383.9</u>	<u>\$ 358.2</u>

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

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's net product sales are represented by the sale of products in the following geographic areas for the years ended December 31:

	2010	2009	2008
	(In millions)		
United States	\$ 2,990.1	\$ 2,642.2	\$ 2,384.7
International	425.8	57.1	22.5
	<u>\$ 3,415.9</u>	<u>\$ 2,699.3</u>	<u>\$ 2,407.2</u>

The Company's net product sales are represented by the sale of products in the following therapeutic categories for the years ended December 31:

	2010	2009	2008
	(In millions)		
Central nervous system	\$ 907.6	\$ 836.7	\$ 795.7
Hormones and synthetic substitutes	682.3	609.8	525.7
Cardiovascular	594.6	269.4	245.5
Anti-infective agents	161.5	133.7	116.8
Urology	127.3	111.4	88.7
Other	942.6	738.3	634.8
	<u>\$ 3,415.9</u>	<u>\$ 2,699.3</u>	<u>\$ 2,407.2</u>

NOTE 14 — Business Restructuring Charges

Activity related to our business restructuring and facility rationalization activities primarily consisted of restructuring activities involving facilities at Carmel, New York; Mississauga, Canada; and Melbourne, Australia for the year ended December 31, 2010 as follows:

	Accrual Balance at December 31, 2009	Charged to Expense	Cash Payments (In millions)	Non-Cash Adjustments	Accrual Balance at December 31, 2010
Cost of sales					
Severance and retention	\$ 13.1	\$ 5.9	\$ (6.1)	\$ —	\$ 12.9
Product transfer costs	1.0	3.3	(2.9)	—	1.4
Facility decommission costs	0.2	10.7	(9.3)	—	1.6
Accelerated depreciation	—	10.4	—	(10.4)	—
	<u>14.3</u>	<u>30.3</u>	<u>(18.3)</u>	<u>(10.4)</u>	<u>15.9</u>
Operating expenses					
R&D	0.8	8.1	(5.8)	—	3.1
Accelerated depreciation — R&D	—	1.4	—	(1.4)	—
Selling, general and administrative	0.8	1.7	(1.5)	—	1.0
	<u>1.6</u>	<u>11.2</u>	<u>(7.3)</u>	<u>(1.4)</u>	<u>4.1</u>
Total restructuring activity	<u>\$ 15.9</u>	<u>\$ 41.5</u>	<u>\$ (25.6)</u>	<u>\$ (11.8)</u>	<u>\$ 20.0</u>

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Activity related to our business restructuring and facility rationalization activities primarily consisted of restructuring activities at Carmel, New York and Brewster, New York for the year ended December 31, 2009 as follows:

	Accrual Balance at December 31, 2008	Charged to Expense	Cash Payments (In millions)	Non-Cash Adjustments	Accrual Balance at December 31, 2009
Cost of sales	\$ 14.6	\$ 29.3	\$ (22.4)	\$ (7.2)	\$ 14.3
Operating expenses					
R&D	0.7	2.3	(1.8)	(0.4)	0.8
Selling, general and administrative	0.8	1.0	(1.0)	—	0.8
Total restructuring activity	\$ 16.1	\$ 32.6	\$ (25.2)	\$ (7.6)	\$ 15.9

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

During the first quarter of 2008, we announced steps to improve our operating cost structure and achieve operating efficiencies through our Global Supply Chain Initiative ("GSCI"). These 2008 GSCI's include the planned closure of manufacturing facilities in Carmel, New York, our distribution center in Brewster, New York and the transition of manufacturing to our other manufacturing locations within the U.S. and India. Distribution activities at our distribution center in Brewster, New York ceased in July 2009. Product manufacturing ceased in Carmel, New York by December 31, 2010 and we expect a closure of the facility by early 2011. During the second quarter of 2010, the Company announced additional measures to reduce its cost structure involving a manufacturing facility and certain R&D activities in Canada and certain R&D activities in Australia. In January 2011, the Company announced the closure of R&D activities in Corona, California. These additional restructuring activities, and the transfer of development activities to existing R&D sites, are expected to be completed in Australia by early 2011, in Corona by the end of 2011 and in Canada by late 2012.

NOTE 15 — Fair Value Measurement

In September 2006, the FASB issued authoritative guidance for fair value measurements, which defines fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. The Company adopted the provisions of the guidance 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 the provisions of the guidance for nonfinancial assets and liabilities measured at fair value on a non-recurring basis effective January 1, 2009. Although the adoption of the guidance did not materially impact the Company's financial condition, results of operations or cash flows, we are required to provide additional disclosures within our consolidated financial statements.

The guidance 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 the guidance 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 (using unobservable inputs supported by little or no market activity based

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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.

Financial assets and liabilities measured at fair value or disclosed at fair value on a recurring basis as at December 31, 2010 and 2009 consisted of the following (in millions):

	Fair Value Measurements as at December 31, 2010 Using:			
	Total	Level 1	Level 2	Level 3
Assets:				
Marketable securities	\$ 11.1	\$ 11.1	\$ —	\$ —
Investments	23.1	23.1	—	—
Liabilities:				
Contingent consideration	198.5	—	—	198.5

	Fair Value Measurements as at December 31, 2009 Using:			
	Total	Level 1	Level 2	Level 3
Assets:				
Marketable securities	\$ 13.6	\$ 13.6	\$ —	\$ —
Investments	3.0	3.0	—	—
Liabilities:				
Contingent consideration	111.0	—	—	111.0

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.

The fair value measurement of the contingent consideration obligations is determined using Level 3 inputs. The fair value of contingent consideration obligations is based on a probability-weighted income approach. The measurement is based upon unobservable inputs supported by little or no market activity based on our own assumptions. Changes in the fair value of the contingent consideration obligations are recorded as a component of operating income in our consolidated statement of operations.

The tables below provide a summary of the changes in fair value, including net transfers in and/or out, of all financial assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2010 and 2009 (in millions):

	Balance at December 31, 2009	Net Transfers in to (Out of) Level 3	Purchases, Sales, Settlements, Issuances, Net	Total Realized and Unrealized Gains (Losses)	Ending Balance at December 31, 2010
Liabilities:					
Contingent consideration obligations	\$ 111.0	\$ —	\$ 64.8	\$ 22.7	\$ 198.5
	Balance at December 31, 2008	Net Transfers in to (Out of) Level 3	Purchases, Sales, Settlements, Issuances, Net	Total Realized and Unrealized Gains (Losses)	Ending Balance at December 31, 2009
Liabilities:					
Contingent consideration obligations	\$ —	\$ —	\$ 110.0	\$ 1.0	\$ 111.0

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

NOTE 16 — Commitments and Contingencies

Facility and Equipment Leases

The Company has operating leases for certain facilities and equipment. The terms of the operating leases for the Company's facilities require the Company to pay property taxes, normal maintenance expenses and maintain minimum insurance coverage. Total rental expense for operating leases in 2010, 2009 and 2008 was \$26.0 million, \$20.0 million and \$19.0 million, respectively.

At December 31, 2010, future minimum lease payments under all non-cancelable operating leases are approximately, \$24.4 million in 2011, \$18.6 million in 2012, \$14.6 million in 2013, \$12.5 million in 2014, \$12.8 million in 2015 and \$53.0 million thereafter.

Employee Retirement Plans

The Company maintains certain defined contribution retirement plans covering substantially all U.S.-based employees. The Company contributes to the plans based upon the employee contributions. Watson's contributions to these retirement plans were \$9.5 million, \$11.0 million and \$10.6 million in the years ended December 31, 2010, 2009 and 2008, respectively. The Company does not sponsor any defined benefit retirement plans or postretirement benefit plans.

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 have 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 and denied the plaintiffs' motions for class certification. On May 7, 2005, three groups of plaintiffs from the consolidated action (the direct purchaser plaintiffs, the indirect purchaser plaintiffs and plaintiffs Rite Aid and CVS) filed notices of appeal in the United States Court of Appeals for the Second Circuit, appealing, among other things, the May 20, 2003 order dismissing Watson and the March 31, 2005 order granting summary judgment in favor of the defendants. On November 7, 2007, the U.S. Court of Appeals for the Second Circuit 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 June 22, 2009, the Supreme Court denied the indirect purchaser plaintiffs' petition for writ of certiorari. In the appeal in the United States Court of Appeals for the Second Circuit by the direct purchaser plaintiffs and plaintiffs CVS and Rite Aid, on April 29, 2010, the United States Court of Appeals

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

for the Second Circuit affirmed the ruling of the District Court granting summary judgment in favor of the defendants, and on September 7, 2010, denied the appellants' petition for rehearing en banc. On December 6, 2010, the appellants filed a petition for writ of certiorari with the United States Supreme Court seeking review of the Second Circuit's decision. The defendants filed their opposition to the petition on February 7, 2011. Other actions are pending in various state courts, including 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 ("Sanofi"), 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. In the action pending in Kansas, the court has administratively terminated the matter pending the outcome of the appeals 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 ruled that the majority of the plaintiffs would be permitted to pursue their claims as a class. On August 31, 2009, the California Superior Court granted defendants' motion for summary judgment, and final judgment was entered on September 24, 2009. On November 19, 2009, the plaintiffs filed a notice of appeal. The appeal remains pending. In addition to the pending actions, Watson understands that various state and federal agencies are investigating the allegations made in these actions. Sanofi 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 it, along with numerous other pharmaceutical companies, is a defendant in a *qui tam* action brought in 1995 under the U.S. False Claims Act currently pending in the U.S. District Court for the Southern District of Florida. Watson Pharma has not been served in the *qui tam* action. A *qui tam* action is a civil lawsuit brought by an individual or a company (the "qui tam relator") for an alleged violation of a federal statute, in which the U.S. Department of Justice has the right to intervene and take over the prosecution of the lawsuit at its option. Pursuant to applicable federal law, the *qui tam* action is under seal as to Watson Pharma. The Company believes that the *qui tam* action relates to whether allegedly improper price reporting by pharmaceutical manufacturers led to increased payments by Medicare and/or Medicaid. The *qui tam* action may seek to recover damages from Watson Pharma based on its price reporting practices. Watson Pharma subsequently also received and responded to notices or subpoenas from the Attorneys General of various states, including Florida, Nevada, New York, California and Texas, relating to pharmaceutical pricing issues and whether allegedly improper actions by pharmaceutical manufacturers led to excessive payments by Medicare and/or Medicaid. On June 26, 2003, the Company received a request for records and information from the U.S. House Committee on Energy and Commerce in connection with that committee's investigation into pharmaceutical reimbursements and rebates under Medicaid. The Company produced documents in response to the request. Other state and federal inquiries regarding pricing and reimbursement issues are anticipated.

Beginning in July 2002, the Company and certain of its subsidiaries, as well as numerous other pharmaceutical companies, were named as defendants in various state and federal court actions alleging improper or fraudulent reporting practices related to the reporting of average wholesale prices and wholesale acquisition costs of certain products, and that the defendants committed other improper acts in order to increase prices and market shares. Some of these actions have been consolidated in the U.S. District Court for the District of Massachusetts (*In re: Pharmaceutical Industry Average Wholesale Price Litigation, MDL Docket No. 145*). The consolidated amended Class Action complaint in that case alleges that the defendants' acts improperly inflated the reimbursement amounts of certain drugs paid by various public and private plans and programs. Certain defendants, including the Company, have entered into a settlement agreement resolving

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

all claims against them in the Consolidated Class Action. The total amount of the settlement for all of the settling defendants is \$125 million. The amount to be paid by each settling 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 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, Iowa, Oklahoma and Louisiana 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 (the "Florida Ven-A-Care Action")*; *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 USP 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 (the "Iowa AG Action"); *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 (the "Texas Ven-A-Care Action"); *United States of America ex rel. Ven-A-Care of the Florida Keys, Inc., v. Actavis Mid-Atlantic LLC, Civil Action No. 08-10852, in the U.S. District Court for the District of Massachusetts (the "Federal Ven-A-Care Action")*; *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; *State of Oklahoma, ex rel., W.A. Drew Edmondson, Attorney General of Oklahoma v. Abbott Laboratories, Inc., et al.*, Case No. CJ-2010-474, District Court of Pottawatomie County, Oklahoma, and *State of Louisiana v. Abbott Laboratories, Inc., et al.*, Case No. 596144, Parish of East Baton Rouge, 19th Judicial District. In December of 2010, the State of Utah served the Company with a Civil Investigative Demand seeking additional information relating to the Company's pricing practices.

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On August 4, 2004, the City of New York filed an action against the Company and numerous other pharmaceutical defendants alleging similar claims. The case has been consolidated with similar cases filed by forty one individual New York counties. (*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*) (hereinafter the "Consolidated NY Counties Actions"), as well as by four additional New York counties, with three of these cases pending in New York state courts. On January 27, 2010, the U.S. District Court granted Plaintiffs' motion in the Consolidated NY Counties Actions for partial summary judgment as to each of the generic defendants, including Watson, with respect to some of Watson's drugs reimbursed at the Federal Upper Limit, and found violations of New York's state false claims act statute.

In August 2010, the Company reached an agreement in principle to settle each of the following pending actions: the Texas Ven-a-Care Action, the Florida Ven-a-Care Action, the Federal Ven-A-Care Action, the Iowa AG Action, and the Consolidated New York Counties Action (collectively the "Ven-A-Care Settlement"). The Ven-A-Care Settlement was contingent upon approval of the United States Department of Justice and the execution of definitive settlement documents. In December of 2010, after the parties failed to finalize the Ven-A-Care Settlement, the Company reached an agreement in principle to settle the following pending actions: the Texas Ven-a-Care Action, the Florida Ven-a-Care Action, the Iowa AG Action, and the Consolidated New York Counties Action (the "State Ven-A-Care Settlement"). In addition, at the same time the Company reached an agreement in principle to settle claims pending in the Federal Ven-A-Care Action relative to the Texas, Florida, Iowa and New York Medicaid programs (the "Federal Ven-A-Care Settlement," and collectively with the State Ven-A-Care Settlement, the "December 2010 Ven-A-Care Settlement"). The total amount to be paid by the Company under the terms of the proposed December 2010 Ven-A-Care Settlement is \$79 million. The December 2010 Ven-A-Care Settlement is contingent upon obtaining final approval by the U.S. Department of Justice and the execution of definitive settlement documents.

The cases against the Company on behalf of Arizona, Hawaii and Massachusetts have been settled. The case against the Company on behalf of Alabama was tried in 2009. The jury was unable to reach a verdict, and the court declared a mistrial and ordered the case to be retried. New trials against the Company and Andrx Corporation, a Company subsidiary, are scheduled for May and August of 2011, respectively. The case against the Company on behalf of Kentucky is scheduled for trial in November of 2011. The case against the Company on behalf of Mississippi is scheduled for trial in June 2011. The case against the Company on behalf of Alaska is scheduled for trial in January of 2012. The case against the Company on behalf of Idaho is scheduled for trial in March 2012. The case against the Company on behalf of Missouri is scheduled for trial in June of 2012.

The Company has accrued a \$129.9 million liability reserve on its balance sheet in connection with the December 2010 Ven-A-Care Settlement and the remaining drug pricing actions. The December 2010 Ven-A-Care Settlement will resolve a considerable portion of the damages claims asserted against the Company and its affiliates in the various pending pricing litigations. With regard to the remaining drug pricing actions, the Company believes that it has meritorious defenses and intends to vigorously defend itself in those actions. The Company continually monitors the status of these actions and may settle or otherwise resolve some or all of these matters on terms that the Company deems to be in its best interests. However, the

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Company can give no assurance that it will be able to settle the remaining actions on terms it deems reasonable, or that such settlements or adverse judgments in the remaining actions, if entered, will not exceed the amounts of the liability reserves. 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 could have a material adverse effect on the Company's business, results of operations, financial condition and cash flows.

Medicaid Drug Reimbursement Litigation. In December 2009, the Company learned that numerous pharmaceutical companies, including certain subsidiaries of the Company, have been named as defendants in a qui tam action pending in the United States District Court for the District of Massachusetts (*United States of America ex rel. Constance A. Conrad v. Actavis Mid-Atlantic, LLC, f/k/a Biovail Pharmaceuticals, LLC, et. al., USDC Case No. 02-CV-11738-NG*). The seventh amended complaint, which was served on certain of the Company's subsidiaries in December 2009, alleges that the defendants falsely reported to the United States that certain pharmaceutical products were eligible for Medicaid reimbursement and thereby allegedly caused false claims for payment to be made through the Medicaid program. In December 2010 the plaintiff served a ninth amended complaint that unseals the action in its entirety and continues to allege the previously asserted claims against certain subsidiaries of the Company. The Company believes that it has meritorious defenses to the claims and intends to vigorously defend itself in the action. However, this action, if successful, 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.

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 each year since 2002, the independent expert has reported its opinion to the FDA that, based on the findings of the audit of the facility, the FDA's applicable cGMP requirements, applicable FDA regulatory guidance, and the collective knowledge, education, qualifications and experience of the expert's auditors and reviewers, the systems at Watson's Corona facility audited and evaluated by the expert are in compliance with the FDA's cGMP regulations. However, the FDA is not required to accept or agree with the independent expert's opinion. The FDA has conducted periodic inspections of the Corona facility since the entry of the consent decree. The FDA's most recent inspection was conducted from August 2, 2010 through August 13, 2010. 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 FDA's inspectional observations, 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 cash flows.

Federal Trade Commission Investigations. The Company has received Civil Investigative Demands or requests for information from the Federal Trade Commission seeking information and documents related to the terms on which the Company has settled lawsuits initiated by patentees under the Hatch-Waxman Act, and

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

other commercial arrangements between the Company and third parties. These investigations include the Company's August 2006 settlement with Cephalon, Inc. related to the Company's generic version of Provigil[®] (modafinil). 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 alleged 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, in violation of federal and state antitrust and consumer protection laws. The complaint sought 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 April 8, 2009, the Court transferred the government and private cases to the United States District Court for the Northern District of Georgia. On April 21, 2009 the State of California voluntarily dismissed its lawsuit against the Company without prejudice. The Federal Trade Commission and the private plaintiffs in the Northern District of Georgia filed amended complaints on May 28, 2009. The private plaintiffs amended their complaints to include allegations concerning conduct before the U.S. Patent and Trademark Office, conduct in connection with the listing of Solvay's patent in the Food and Drug Administration's "Orange Book," and sham litigation. Additional actions alleging similar claims have been filed in various courts by other private plaintiffs purporting to represent certain classes of similarly situated direct or indirect purchasers of AndroGel[®] (*Stephen L. LaFrance Pharm., Inc. d/b/a SAJ Dist. v. Unimed Pharms., Inc., et al., D. NJ Civ. No. 09-1507*); (*Fraternal Order of Police, Fort Lauderdale Lodge 31, Insurance Trust Fund v. Unimed Pharms. Inc., et al., D. NJ Civ. No. 09-1856*); (*Scurto v. Unimed Pharms., Inc., et al., D. NJ Civ. No. 09-1900*); (*United Food and Commercial Workers Unions and Employers Midwest Health Benefits Fund v. Unimed Pharms., Inc., et al., D. MN Civ. No. 09-1168*); (*Rite Aid Corp. et al. v. Unimed Pharms., Inc. et al., M.D. PA Civ. No. 09-1153*); (*Walgreen Co., et al. v. Unimed Pharms., LLC, et al., MD. PA Civ. No. 09-1240*); (*Supervalu, Inc. v. Unimed Pharms., LLC, et al, ND. GA Civ. No. 10-1024*); (*LeGrand v. Unimed Pharms., Inc., et al., ND. GA Civ. No. 10-2883*); (*Jabo's Pharmacy Inc. v. Solvay Pharmaceuticals, Inc., et al., Cocke County, TN Circuit Court Case No. 31,837*). On April 20, 2009, the Company was dismissed without prejudice from the *Stephen L. LaFrance* action pending in the District of New Jersey. On October 5, 2009, the Judicial Panel on Multidistrict Litigation transferred all actions then pending outside of the United States District Court for the Northern District of Georgia to that district for consolidated pre-trial proceedings (*In re: AndroGel[®] Antitrust Litigation (No. II), MDL Docket No. 2084*), and all currently-pending related actions are presently before that court. On February 22, 2010, the judge presiding over all the consolidated litigations related to AndroGel[®] then pending in the United States District Court for the Northern District of Georgia granted the Company's motions to dismiss the complaints, except the portion of the private plaintiffs' complaints that include allegations concerning sham litigation. On July 20, 2010, the plaintiff in the *Fraternal Order of Police* action filed an amended complaint adding allegations concerning conduct before the U.S. Patent and Trademark Office, conduct in connection with the listing of Solvay's patent in the Food and Drug Administration's "Orange Book," and sham litigation similar to the claims raised in the direct purchaser actions. On October 28, 2010, the judge presiding over MDL 2084 entered an order pursuant to which the *LeGrand* action, filed on September 10, 2010, was consolidated for pretrial purposes with the

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

other indirect purchaser class action as part of MDL 2084 and made subject to the Court's February 22, 2010 order on the motion to dismiss. Discovery in the private actions is ongoing. Final judgment in favor of the defendants was entered in the Federal Trade Commission's action on April 21, 2010. On June 10, 2010, the Federal Trade Commission filed a notice of appeal to the Eleventh Circuit Court of Appeals, appealing the district court's dismissal of its complaint. The appeal is pending.

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.

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 100 cases are pending against Watson and/or its affiliates in state and federal courts representing claims by approximately 100 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 believes it has substantial meritorious defenses to these cases and maintains product liability insurance against such cases. However, litigation is inherently uncertain and the Company cannot predict the outcome of this litigation. These actions, if successful, or if insurance does not provide sufficient coverage against such 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.

Fentanyl Transdermal System Litigation. Beginning in 2009, a number of product liability suits were filed against the Company and certain Company affiliates, as well as other manufacturers and distributors of fentanyl transdermal system products, for personal injuries or deaths allegedly arising out of the use of the fentanyl transdermal system products. Approximately 38 cases are pending against the Company and/or its affiliates in state and federal courts, representing claims by approximately 110 plaintiffs. Discovery is ongoing. The Company believes it has substantial meritorious defenses to these cases and maintains product liability insurance against such cases. However, litigation is inherently uncertain and the Company cannot predict the outcome of this litigation. These actions, if successful, or if insurance does not provide sufficient coverage against such 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.

Metoclopramide Litigation. Beginning in 2009, a number of product liability suits were filed against the Company and certain Company affiliates, as well as other manufacturers and distributors of metoclopramide, for personal injuries allegedly arising out of the use of metoclopramide. Approximately 300 cases are pending against the Company and/or its affiliates in state and federal courts, representing claims by approximately 800 plaintiffs. These cases are generally at their preliminary stages and discovery is ongoing. The Company believes that it will be indemnified for the majority of these claims by Pliva, Inc., an affiliate of Teva Pharmaceutical Industries, Ltd., from whom the Company purchased its metoclopramide product in late 2008. Further, the Company believes that it has substantial meritorious defenses to these cases and maintains product liability insurance against such cases. However, litigation is inherently uncertain and the Company cannot predict the outcome of this litigation. These actions, if successful, or if our indemnification arrangements or insurance do not provide sufficient coverage against such 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.

Medical West Ballas Pharmacy, LTD, et al. v. Anda, Inc., (Circuit Court of the County of St. Louis, State of Missouri, Case No. 08SL-CC00257). In January 2008, Medical West Ballas Pharmacy, LTD, filed a

**WATSON
PHARMACEUTICALS, INC.**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

purported class action complaint against the Company alleging conversion and alleged violations of the Telephone Consumer Protection Act ("TCPA") and Missouri Consumer Fraud and Deceptive Business Practices Act. In April 2008, plaintiff filed an amended complaint substituting Anda, Inc., a subsidiary of the Company, as the defendant. The amended complaint alleges that by sending unsolicited facsimile advertisements, Anda misappropriated the class members' paper, toner, ink and employee time when they received the alleged unsolicited faxes, and that the alleged unsolicited facsimile advertisements were sent to the plaintiff in violation of the TCPA and Missouri Consumer Fraud and Deceptive Business Practices Act. The complaint seeks to assert class action claims on behalf of the plaintiff and other similarly situated third parties. In April 2008, Anda filed an answer to the amended complaint, denying the allegations. In November 2009, the court granted plaintiff's motion to expand the class of plaintiffs from individuals for which Anda lacked evidence of express permission or an established business relationship to "All persons who on or after four years prior to the filing of this action, were sent telephone facsimile messages advertising pharmaceutical drugs and products by or on behalf of Defendant." In November 2010, the plaintiff filed a second amended complaint further expanding the definition and scope of the proposed class of plaintiffs. On November 30, 2010, Anda filed a petition with the Federal Communications Commission ("FCC"), asking the FCC to clarify the statutory basis for its regulation requiring "opt-out" language on faxes sent with express permission of the recipient. The FCC's ruling on Anda's petition may determine whether fax recipients who expressly agree to receive faxes may assert claims for receipt of such faxes pursuant to the TCPA. On December 2, 2010, Anda filed a motion to dismiss claims the plaintiff is seeking to assert on behalf of putative class members who expressly consented or agreed to receive faxes from Defendant, or in the alternative, to stay the court proceedings pending resolution of Anda's petition to the FCC. The motion remains pending. No trial date has been set. Anda intends to defend the action vigorously. However, this action, if successful, could have an adverse effect on the Company's business, results of operations, financial condition and cash flows.

Drospirenone/Ethinyl Estradiol Tablets (Generic version of Yasmin®). On April 7, 2008, Bayer Schering Pharma AG sued the Company in the United States District Court for the Southern District of New York, alleging that sales of the Company's drospirenone/ethinyl estradiol tablets, a generic version of Bayer's Yasmin® tablets, infringes Bayer's U.S. Patent No. 5,569,652 (*Bayer Schering Pharma AG v. Watson Pharmaceuticals, Inc., et. al., Case No. 08cv3710*). The complaint sought damages and injunctive relief. On September 28, 2010, the district court granted the Company's motion for judgment on the pleadings and dismissed the case with prejudice. Final judgment was entered on January 7, 2011. On January 21, 2011, Bayer filed a Notice of Appeal with the United States Court of Appeals for the Second Circuit. 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 Yasmin®. Therefore, an adverse ruling on the appeal or a subsequent final determination that the Company has infringed the patent in suit could have a material adverse effect on the Company's business, results of operations, financial condition and cash flows.

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.

Schedule II
Watson Pharmaceuticals, Inc.
Valuation and Qualifying Accounts
Years Ended December 31, 2010, 2009 and 2008

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions/ Write-offs	Other*	Balance at End of Period
	(In millions)				
Allowance for doubtful accounts:					
Year ended December 31, 2010	\$ 5.4	\$ 9.5	\$ (2.4)	—	\$ 12.5
Year ended December 31, 2009	3.3	3.4	(3.1)	1.8	5.4
Year ended December 31, 2008	3.8	1.2	(1.7)	—	3.3
Inventory reserves:					
Year ended December 31, 2010	77.7	50.0	(76.3)	—	51.4
Year ended December 31, 2009	34.7	51.0	(22.4)	14.4	77.7
Year ended December 31, 2008	47.7	45.7	(58.7)	—	34.7
Tax valuation allowance:					
Year ended December 31, 2010	28.4	7.3	(6.0)	—	29.7
Year ended December 31, 2009	8.1	0.2	—	20.1	28.4
Year ended December 31, 2008	12.5	(0.6)	(3.8)	—	8.1

* Represents opening balances of businesses acquired in the period.

SUPPLEMENTARY DATA (UNAUDITED)

Selected unaudited quarterly consolidated financial data and market price information are shown below (in millions except per share data):

	For Three Month Periods Ended			
	Dec. 31, 2010	Sept. 30, 2010	June 30, 2010	Mar. 31, 2010
Net revenues	\$ 952.7	\$ 882.4	\$ 875.3	\$ 856.5
Operating expenses	897.1	848.0	759.6	756.2
Operating income	55.0	34.4	115.7	100.3
Provision for income taxes	14.9	(12.2)	27.9	36.7
Net income	\$ 18.3	\$ 25.7	\$ 70.6	\$ 69.8
Basic earnings per share	\$ 0.15	\$ 0.21	\$ 0.58	\$ 0.57
Diluted earnings per share	\$ 0.15	\$ 0.21	\$ 0.57	\$ 0.57
Market price per share:				
High	\$ 52.20	\$ 45.15	\$ 44.97	\$ 42.50
Low	\$ 42.17	\$ 39.34	\$ 40.50	\$ 37.26

	For Three Month Periods Ended			
	Dec. 31, 2009	Sept. 30, 2009	June 30, 2009	Mar. 31, 2009
Net revenues	\$ 785.7	\$ 662.1	\$ 677.8	\$ 667.4
Operating expenses	685.5	551.4	586.3	585.9
Operating income	100.2	110.7	91.5	81.5
Provision for income taxes	32.8	39.3	37.6	30.9
Net income	\$ 56.9	\$ 63.0	\$ 53.0	\$ 49.1
Basic earnings per share	\$ 0.52	\$ 0.61	\$ 0.51	\$ 0.48
Diluted earnings per share	\$ 0.51	\$ 0.55	\$ 0.46	\$ 0.43
Market price per share:				
High	\$ 40.25	\$ 37.20	\$ 33.97	\$ 32.95
Low	\$ 33.88	\$ 32.61	\$ 28.06	\$ 23.05

EXHIBIT INDEX

Exhibit No.	Description
2.1	Agreement and Plan of Merger by and among Watson Pharmaceuticals, Inc., Water Delaware, Inc. and Andrx Corporation dated March 12, 2006, is incorporated by reference to Exhibit 2.1 to the Company's March 13, 2006 Form 8-K.
2.2	Share Purchase Agreement dated as of June 16, 2009, by and among Robin Hood Holdings Limited, Watson Pharmaceuticals, Inc., certain shareholders of Robin Hood Holdings Limited, and Anthony Selwyn Tabatznik, solely in his capacity as the Shareholders' Representative, is incorporated by reference to Exhibit 2.1 to the Company's June 16, 2009 Form 8-K.
2.3	First Amendment to Share Purchase Agreement, dated as of November 26, 2009, by and among Robin Hood Holdings Limited, Arrow Pharmaceutical Holdings Ltd., Cobalt Laboratories, Inc., Arrow International Ltd., Arrow Supplies Ltd., Watson Pharmaceuticals, Inc., Watson Pharma S.A.R.L., Watson Cobalt Holdings, LLC, the shareholders of Robin Hood Holdings Limited, and Anthony Selwyn Tabatznik, solely in his capacity as Shareholders' Representative, is incorporated by reference to Exhibit 2.2 to the Company's November 26, 2009 Form 8-K.
3.1	Articles of Incorporation of the Company and all amendments thereto are incorporated by reference to Exhibit 3.1 to the Company's June 30, 1995 Form 10-Q and to Exhibit 3.1(A) to the Company's June 30, 1996 Form 10-Q.
3.2	Second Amended and Restated Bylaws of Watson Pharmaceuticals, Inc. are incorporated by reference to Exhibit 3.1 to the Company's March 5, 2009 Form 8-K.
3.3	Certificate of Designations for Series A Preferred Stock is incorporated by reference to Exhibit 3.1 to the Company's November 26, 2009 Form 8-K.
4.1	Indenture between the Company and Wells Fargo Bank, N.A., as trustee, dated as of August 24, 2009, is incorporated by reference to Exhibit 4.1 to the Company's August 18, 2009 Form 8-K.
4.2	First Supplemental Indenture between the Company and Wells Fargo Bank, N.A., as trustee, dated as of August 24, 2009, including the forms of the Company's 5.000% Senior Notes due 2014 and 6.125% Senior Notes due 2019, is incorporated by reference to Exhibit 4.2 to the Company's August 18, 2009 Form 8-K.
4.3	Second Supplemental Indenture between the Company and Wells Fargo Bank, N.A., as trustee, dated as of May 7, 2010, is incorporated by reference to Exhibit 10. to the Company's March 31, 2010 10-Q.
4.4	Shareholders Agreement, dated as of December 2, 2009, by and among Watson Pharmaceuticals, Inc., Quiver Inc. and Friar Tuck Limited, is incorporated by reference to Exhibit 4.1 to the Company's November 26, 2009 Form 8-K.
*10.1	1991 Stock Option Plan of the Company, as revised, is incorporated by reference to Exhibit 10.1 to the Company's June 30, 1995 Form 10-Q. Plan amendments are incorporated by reference to Exhibit 10.6(a) to the Company's June 30, 1996 Form 10-Q and by reference to Exhibit 10.6(a) to the Company's March 31, 1997 Form 10-Q.
*10.2	Amendment and Restatement of the 2001 Incentive Award Plan of Watson Pharmaceuticals, Inc. is incorporated by reference to Exhibit 10.1 to the Company's June 30, 2005 Form 10-Q. Second Amendment and Restatement of the 2001 Incentive Award Plan of Watson Pharmaceuticals, Inc. is incorporated by reference to Exhibit 10.1 to the Company's March 31, 2007 Form 10-Q. Third Amendment and Restatement of the 2001 Incentive Award Plan of Watson Pharmaceuticals, Inc.
*10.3	Key Employee Agreement entered into as of February 28, 2000, between David A. Buchen and the Company is incorporated by reference to Exhibit 10.4 to the Company's 2000 Form 10-K.
*10.4	Amendment to Key Employment Agreement entered into as of December 31, 2008, between David A. Buchen and the Company, is incorporated by reference to Exhibit 10.9 to the Company's 2008 Form 10-K.
*10.5	Key Employment Agreement entered into as of September 5, 2006 by and between Thomas R. Russillo and the Company is incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on September 7, 2006.

Table of Contents

Exhibit No.	Description
*10.6	Amendment to Watson Pharmaceuticals, Inc. Key Employment Agreement entered into as of December 29, 2008 by and between Thomas R. Russillo and the Company is incorporated by reference to Exhibit 10.6 to the Company's 2008 Form 10-K.
*10.7	Amendment to Key Employment Agreement entered into as of December 31, 2008, between AI Paonessa III and the Company, is incorporated by reference to Exhibit 10.8 to the Company's 2008 Form 10-K.
10.8	Credit Agreement by and among Watson Pharmaceuticals, Inc., Canadian Imperial Bank of Commerce, Wachovia Capital Markets, LLC, Wells Fargo Bank, National Association, Union Bank of California, N.A. and Sumitomo Mitsui Banking Corporation dated November 3, 2006 is incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on November 6, 2006.
*10.9	2001 Incentive Award Plan Form of Notice of Grant and Signature Page for an Employee or a Consultant is incorporated by reference to Exhibit 10.15 to the Company's 2004 Form 10-K.
*10.10	2001 Incentive Award Plan Form of Notice of Grant and Signature Page for a Director is incorporated by reference to Exhibit 10.16 to Exhibit 10.16 to the Company's 2004 Form 10-K.
*10.11	Form of Amendment and Restatement of the 2001 Incentive Award Plan Notice of Grant and Signature Page for a Non-Employee Director Restricted Stock Award is incorporated by reference to Exhibit 10.2 to the Company's June 30, 2005 Form 10-Q.
*10.12	Form of Amendment and Restatement of the 2001 Incentive Award Plan Notice of Grant and Signature Page for a Non-Employee Director Option Grant is incorporated by reference to Exhibit 10.3 to the Company's June 30, 2005 Form 10-Q.
*10.13	Form of Amendment and Restatement of the 2001 Incentive Award Plan Notice of Grant and Signature Page for an Employee Restricted Stock Award is incorporated by reference to Exhibit 10.4 to the Company's June 30, 2005 Form 10-Q.
*10.14	Form of Amendment and Restatement of the 2001 Incentive Award Plan Notice of Grant and Signature Page for an Employee Stock Option Award is incorporated by reference to Exhibit 10.5 to the Company's June 30, 2005 Form 10-Q.
*10.15	Form of Amendment and Restatement of the 2001 Incentive Award Plan Notice of Grant and Signature Page for a Vice-President and Above Stock Option Award is incorporated by reference to Exhibit 10.6 to the Company's June 30, 2005 Form 10-Q.
*10.16	Form of Amendment and Restatement of the 2001 Incentive Award Plan Notice of Grant and Signature Page for a Vice-President and Above Restricted Stock Award is incorporated by reference to Exhibit 10.22 to the Company's 2006 Form 10-K.
*10.17	Key Employee Agreement between Watson Pharmaceuticals, Inc. and Paul M. Bisaro, dated as of August 1, 2007, is incorporated by reference to Exhibit 10.2 to the Company's August 1, 2007 Form 8-K.
*10.18	Amendment to Watson Pharmaceuticals, Inc. Key Employee Agreement entered into as of December 22, 2008 by and between Paul M. Bisaro and the Company is incorporated by reference to Exhibit 10.27 to the Company's 2008 Form 10-K.
*10.19	Key Employee Agreement between Anda, Inc. and AI Paonessa III, dated as of August 2, 2007 is incorporated by reference to Exhibit 10.28 to the Company's 2007 Form 10-K.
10.20	Amendment No. 1, dated July 1, 2009, to the Credit Agreement dated November 3, 2006, by and among Watson Pharmaceuticals, Inc., Canadian Imperial Bank of Commerce, acting through its New York agency, as administrative agent, Wachovia Capital Markets, LLC, as syndication agent, a syndicate of lenders, and Wells Fargo Bank, National Association, Union Bank of California, N.A., Sumitomo Mitsui Banking Corporation, as documentation agents and the financial institutions from time to time party thereto, is incorporated by reference to Exhibit 10.1 to the Company's June 30, 2009 Form 10-Q.
*10.21	Second Amendment to Key Employee Agreement between Watson Pharmaceuticals, Inc. and Thomas R. Russillo, dated as of August 13, 2009, is incorporated by reference to Exhibit 10.1 to the Company's August 13, 2009 Form 8-K.
*10.22	Key Employee Agreement entered into as of October 30, 2009 by and between R. Todd Joyce and the Company is incorporated by reference to Exhibit 10.1 to the Company's October 30, 2009 Form 8-K.

Table of Contents

Exhibit No.	Description
10.23	Purchase and Collaboration Agreement, dated as of March 3, 2010, by and among Columbia Laboratories, Inc., Coventry Acquisition, Inc. and Watson Pharmaceuticals, Inc., is incorporated by reference to Exhibit 2.1 to the Company's March 5, 2010 Form 8-K.
10.24	Consulting agreement between Arrow No. 7 Ltd., and Anthony Selwyn Tabatznik as of May 10, 2010, is incorporated by reference to Exhibit 10.1 to the Company's March 31, 2010 Form 10-Q.
12.1	Statement regarding the computation of ratio of earnings to fixed charges is incorporated by reference to Exhibit 12.1 to the Company's August 17, 2009 Form S-3.
21.1	Subsidiaries of the Company.
23.1	Consent of PricewaterhouseCoopers LLP.
31.1**	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.2**	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
32.1**	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS***	XBRL Instance Document
101.SCH***	XBRL Taxonomy Extension Schema Document
101.CAL***	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF***	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB***	XBRL Taxonomy Extension Label Linkbase Document

* Compensation Plan or Agreement

** Furnished herewith and not "filed" for purposes of Section 18 of the Exchange Act.

*** XBRL information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

+ Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.

**THIRD AMENDMENT AND RESTATEMENT OF
THE 2001 INCENTIVE AWARD PLAN OF
WATSON PHARMACEUTICALS, INC.**

Watson Pharmaceuticals, Inc., a Nevada corporation, adopted the 2001 Incentive Award Plan of Watson Pharmaceuticals, Inc. (the "*Plan*"), effective as of February 12, 2001 (the "*Effective Date*"), for the benefit of its eligible Employees, Consultants and Directors. The Plan was subsequently amended effective as of May 16, 2001, May 19, 2003, and August 4, 2003, May 13, 2005, and November 3, 2006. The Plan was amended and restated in its entirety to provide for certain additional types of awards to eligible Employees, Consultants and Directors, effective as of May 4, 2007.

The Plan is hereby amended and restated to add Section 3.6, titled "Foreign Holders," which sets forth certain provisions related to for awards that may be made to eligible Employees, Consultants and Directors outside of the United States. This amendment and restatement of the Plan is effective as of May 7, 2010.

The purposes of the Plan are as follows:

(1) To provide an additional incentive for Directors, key Employees and Consultants (as such terms are defined below) to further the growth, development and financial success of the Company by personally benefiting through the ownership of Company stock and/or rights which recognize such growth, development and financial success.

(2) To enable the Company to obtain and retain the services of Directors, key Employees and Consultants considered essential to the long range success of the Company by offering them an opportunity to own stock in the Company and/or rights which will reflect the growth, development and financial success of the Company.

**ARTICLE I.
DEFINITIONS**

Wherever the following terms are used in the Plan they shall have the meanings specified below, unless the context clearly indicates otherwise. The singular pronoun shall include the plural where the context so indicates.

1.1. "*Administrator*" shall mean the entity that conducts the general administration of the Plan as provided herein. With reference to the administration of the Plan with respect to Awards granted to Independent Directors, the term "*Administrator*" shall refer to the Board. With reference to the administration of the Plan with respect to any other Award, the term "*Administrator*" shall refer to the Committee unless the Board has assumed the authority for administration of the Plan generally as provided in Section 11.1. With reference to the duties of the Committee under the Plan which have been delegated to one or more persons pursuant to Section 11.5, the term "*Administrator*" shall refer to such person(s) unless the Committee or the Board has revoked such delegation.

1.2. "*Award*" shall mean an Option, a Restricted Stock award, a Restricted Stock Unit award, a Dividend Equivalents award, a Deferred Stock award, a Stock Payment award or a Stock Appreciation Right, which may be awarded or granted under the Plan (collectively, "*Awards*").

1.3. "Award Agreement" shall mean a written agreement executed by an authorized officer of the Company and the Holder which shall contain such terms and conditions with respect to an Award as the Administrator shall determine, consistent with the Plan.

1.4. "Award Limit" shall mean five hundred thousand (500,000) shares of Common Stock, as adjusted pursuant to Section 12.3; provided, however, that each share of Common Stock subject to an Award shall be counted as one share against the Award Limit.

1.5. "Board" shall mean the Board of Directors of the Company.

1.6. "Change in Control" shall mean the occurrence of any of the following:

(a) a sale of assets representing fifty percent (50%) or more of the net book value and of the fair market value of the Company's consolidated assets (in a single transaction or in a series of related transactions);

(b) a liquidation or dissolution of the Company;

(c) a merger or consolidation involving the Company or any subsidiary of the Company after the completion of which: (i) in the case of a merger (other than a triangular merger) or a consolidation involving the Company, the stockholders of the Company immediately prior to the completion of such merger or consolidation beneficially own (within the meaning of Rule 13d-3 promulgated under the Exchange Act, or comparable successor rules), directly or indirectly, outstanding voting securities representing less than sixty percent (60%) of the combined voting power of the surviving entity in such merger or consolidation, and (ii) in the case of a triangular merger involving the Company or a subsidiary of the Company, the stockholders of the Company immediately prior to the completion of such merger beneficially own (within the meaning of Rule 13d-3 promulgated under the Exchange Act, or comparable successor rules), directly or indirectly, outstanding voting securities representing less than sixty percent (60%) of the combined voting power of the surviving entity in such merger and less than sixty percent (60%) of the combined voting power of the parent of the surviving entity in such merger;

(d) an acquisition by any person, entity or "group" (within the meaning of Section 13(d) or 14(d) of the Exchange Act or any comparable successor provisions), other than any employee benefit plan, or related trust, sponsored or maintained by the Company or an affiliate of the Company and other than in a merger or consolidation of the type referred to in subsection (c), of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act, or comparable successor rules) of outstanding voting securities of the Company representing more than thirty percent (30%) of the combined voting power of the Company (in a single transaction or series of related transactions); or

(e) in the event that the individuals who, as of the Effective Date, are members of the Board (the "Incumbent Board"), cease for any reason to constitute at least fifty percent (50%) of the Board; *provided*, that if the election, or nomination for election by the Company's stockholders, of any new member of the Board is approved by a vote of at least fifty percent (50%) of the Incumbent Board, such new member of the Board shall be considered as a member of the Incumbent Board.

1.7. "Code" shall mean the Internal Revenue Code of 1986, as amended.

1.8. "Committee" shall mean the Compensation Committee of the Board, or another committee or subcommittee of the Board, appointed as provided in Section 11.1.

1.9. "Common Stock" shall mean the common stock of the Company, par value \$0.0033 per share.

1.10. "Company" shall mean Watson Pharmaceuticals, Inc., a Nevada corporation.

1.11. "*Consultant*" shall mean any consultant or adviser if: (a) the consultant or adviser renders bona fide services to the Company; (b) the services rendered by the consultant or adviser are not in connection with the offer or sale of securities in a capital-raising transaction and do not directly or indirectly promote or maintain a market for the Company's securities; and (c) the consultant or adviser is a natural person who has contracted directly with the Company to render such services.

1.12. "*Deferred Stock*" shall mean rights to receive Common Stock awarded under Section 8.4 of the Plan.

1.13. "*Director*" shall mean a member of the Board.

1.14. "*Dividend Equivalent*" shall mean a right to receive the equivalent value (in cash or Common Stock) of dividends paid on Common Stock, awarded under Section 8.2 of the Plan.

1.15. "*DRO*" shall mean a domestic relations order as defined by the Code or Title I of the Employee Retirement Income Security Act of 1974, as amended, or the rules thereunder.

1.16. "*Employee*" shall mean any officer or other employee (as defined in accordance with Section 3401(c) of the Code) of the Company, or of any corporation which is a Subsidiary.

1.17. "*Exchange Act*" shall mean the Securities Exchange Act of 1934, as amended.

1.18. "*Fair Market Value*" means, as of any date, the value of a share of Common Stock determined as follows:

(a) If the Common Stock is listed on any established stock exchange (such as the New York Stock Exchange, the NASDAQ Global Market and the NASDAQ Global Select Market) or any national market system, including without limitation any market system of The NASDAQ Stock Market, the value of a share of Common Stock shall be the closing sales price for a share of Common Stock as quoted on such exchange or system for such date, or if there is no closing sales price for a share of Common Stock on the date in question, the closing sales price for a share of Common Stock on the last preceding date for which such quotation exists, as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(b) If the Common Stock is regularly quoted by a recognized securities dealer but closing sales prices are not reported, the value of a share of Common Stock shall be the mean of the high bid and low asked prices for such date or, if there are no high bid and low asked prices for a share of Common Stock on the date in question, the high bid and low asked prices for a share of Common Stock on the last preceding date for which such information exists, as reported in The Wall Street Journal or such other source as the Administrator deems reliable; or

(c) If the Common Stock is neither listed on an established stock exchange or a national market system nor regularly quoted by a recognized securities dealer, the value of a share of Common Stock shall be established by the Administrator in good faith.

1.19. "*Holder*" shall mean a person who has been granted or awarded an Award.

1.20. "*Incentive Stock Option*" shall mean an option which conforms to the applicable provisions of Section 422 of the Code and which is designated as an Incentive Stock Option by the Administrator.

1.21. "*Independent Director*" shall mean a member of the Board who is not an Employee.

1.22. "*Full Value Award*" shall mean any Award other than an Option or Stock Appreciation Right.

1.23. "*Non-Qualified Stock Option*" shall mean an Option which is not designated as an Incentive Stock Option by the Administrator.

1.24. "*Option*" shall mean a stock option granted under Article IV of the Plan. An Option granted under the Plan shall, as determined by the Administrator, be either a Non-Qualified Stock Option or an Incentive Stock Option; *provided, however*, that Options granted to Independent Directors and Consultants shall be Non-Qualified Stock Options.

1.25. "*Performance Criteria*" shall mean any one or more of the following business criteria with respect to the Company, any Subsidiary or any division or operating unit thereof: (a) revenue or sales, (b) net income, (c) pre-tax income, (d) operating income, (e) cash flow, (f) earnings per share, (g) return on equity, (h) return on invested capital or assets, (i) cost reductions or savings, (j) funds from operations, (k) appreciation in the Fair Market Value of Common Stock, or (l) earnings before any one or more of the following: (i) interest, (ii) taxes, (iii) depreciation or (iv) amortization, each as determined in accordance with generally accepted accounting principles.

1.26. "*Plan*" shall mean the 2001 Incentive Award Plan of Watson Pharmaceuticals, Inc., as amended.

1.27. "*Restricted Stock*" shall mean Common Stock awarded under Article VII of the Plan.

1.28. "*Restricted Stock Units*" shall mean rights to receive Common Stock awarded under Section 8.5 of the Plan.

1.29. "*Rule 16b-3*" shall mean Rule 16b-3 promulgated under the Exchange Act, as such Rule may be amended from time to time.

1.30. "*Section 162(m) Participant*" shall mean any key Employee designated by the Administrator as a key Employee whose compensation for the fiscal year in which the key Employee is so designated or a future fiscal year may be subject to the limit on deductible compensation imposed by Section 162(m) of the Code.

1.31. "*Securities Act*" shall mean the Securities Act of 1933, as amended.

1.32. "*Stock Appreciation Right*" shall mean a stock appreciation right granted under Article IX of the Plan.

1.33. "*Stock Payment*" shall mean: (a) a payment in the form of shares of Common Stock, or (b) an option or other right to purchase shares of Common Stock, as part of a deferred compensation arrangement, made in lieu of all or any portion of the compensation, including without limitation, salary, bonuses and commissions, that otherwise would become payable to a key Employee, Independent Director or Consultant in cash, awarded under Section 8.3 of the Plan.

1.34. "*Subsidiary*" shall mean any corporation in an unbroken chain of corporations beginning with the Company if each of the corporations other than the last corporation in the unbroken chain then owns stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

1.35. "*Substitute Award*" shall mean an Option granted under this Plan upon the assumption of, or in substitution for, outstanding equity awards previously granted by a company or other entity in connection with a corporate transaction, such as a merger, combination, consolidation or acquisition of property or stock; *provided, however*, that in no event shall the term "Substitute Award" be construed to refer to an award made in connection with the cancellation and repricing of an Option.

1.36. "*Termination of Consultancy*" shall mean the time when the engagement of a Holder as a Consultant to the Company or a Subsidiary is terminated for any reason, with or without cause, including, but not by way of limitation, by resignation, discharge, death or retirement, but excluding terminations where there is a simultaneous commencement of employment with the Company or any Subsidiary, or any parent thereof. The Administrator, in its absolute discretion, shall determine the effect of all matters and questions relating to Termination of Consultancy, including, but not by way of limitation, the question of

whether a Termination of Consultancy resulted from a discharge for good cause, and all questions of whether a particular leave of absence constitutes a Termination of Consultancy. Notwithstanding any other provision of the Plan, the Company or any Subsidiary has an absolute and unrestricted right to terminate a Consultant's service at any time for any reason whatsoever, with or without cause, except to the extent expressly provided otherwise in writing.

1.37. "*Termination of Directorship*" shall mean the time when a Holder who is an Independent Director ceases to be a Director for any reason, including, but not by way of limitation, a termination by resignation, removal, failure to be elected, death or retirement. The Board, in its sole and absolute discretion, shall determine the effect of all matters and questions relating to Termination of Directorship with respect to Independent Directors.

1.38. "*Termination of Employment*" shall mean the time when the employee-employer relationship between a Holder and the Company or any Subsidiary is terminated for any reason, with or without cause, including, but not by way of limitation, a termination by resignation, discharge, death, disability or retirement; but excluding: (a) terminations where there is a simultaneous reemployment or continuing employment of a Holder by the Company or any Subsidiary, or any parent thereof, (b) at the discretion of the Administrator, terminations which result in a temporary severance of the employee-employer relationship, and (c) at the discretion of the Administrator, terminations which are followed by the simultaneous establishment of a consulting relationship by the Company or a Subsidiary, or any parent thereof, with the former employee. The Administrator, in its absolute discretion, shall determine the effect of all matters and questions relating to Termination of Employment, including, but not by way of limitation, the question of whether a Termination of Employment resulted from a discharge for good cause, and all questions of whether a particular leave of absence constitutes a Termination of Employment; *provided, however,* that, with respect to Incentive Stock Options, unless otherwise determined by the Administrator in its discretion, a leave of absence, change in status from an employee to an independent contractor or other change in the employee-employer relationship shall constitute a Termination of Employment if, and to the extent that, such leave of absence, change in status or other change interrupts employment for the purposes of Section 422(a)(2) of the Code and the then applicable regulations and revenue rulings under said Section.

ARTICLE II. SHARES SUBJECT TO PLAN

2.1. Shares Subject to Plan.

(a) The shares of stock subject to Awards shall be Common Stock. Subject to adjustment as provided in Section 12.3, the aggregate number of such shares of Common Stock which may be issued pursuant to Awards under the Plan shall not exceed 19,728,333 shares. The shares of Common Stock issuable upon exercise of such Options or rights or upon any such Awards may be either previously authorized but unissued shares or treasury shares. The aggregate number of shares of Common Stock available for issuance under the Plan pursuant to this Section 2.1 shall be reduced by two shares for each share of Common Stock delivered in settlement of any Full Value Award.

(b) The maximum number of shares which may be subject to Awards granted under the Plan to any individual in any fiscal year of the Company shall not exceed the Award Limit. To the extent required by Section 162(m) of the Code, shares subject to Awards which are canceled continue to be counted against the Award Limit.

2.2. *Add-Back of Options and Other Rights.* If any Option, or other right to acquire shares of Common Stock under any other Award under the Plan, expires or is canceled without having been fully exercised, the number of shares subject to such Option or other right but as to which such Option or other right was not exercised prior to its expiration, cancellation or exercise may again be optioned, granted or

awarded hereunder, subject to the limitations of Section 2.1; provided, however, that the number of shares that shall again be available for the grant of an Award pursuant to the Plan shall be increased by two shares for each share of Common Stock subject to a Full Value Award at the time such Full Value Award terminates, expires, lapses or is forfeited for any reason. Furthermore, any shares subject to Awards which are adjusted pursuant to Section 12.3 and become exercisable with respect to shares of stock of another corporation shall be considered cancelled and may again be optioned, granted or awarded hereunder, subject to the limitations of Section 2.1. If any shares of Restricted Stock are surrendered by the Holder or repurchased by the Company pursuant to Section 7.4 or 7.5 hereof, such shares may again be optioned, granted or awarded hereunder, subject to the limitations of Section 2.1. To the extent exercised, the full number of shares subject to an Option or Stock Appreciation Right shall be counted for purposes of calculating the aggregate number of shares of Common Stock available for issuance under the Plan as set forth in Section 2.1(a) and for purposes of calculating the share limitation set forth in Section 2.1(b), regardless of the actual number of shares issued or transferred upon any net exercise of an Option (in which Common Stock is withheld to satisfy the exercise price or taxes) or upon exercise of any Stock Appreciation Right for Common Stock or cash. Notwithstanding the provisions of this Section 2.2, no shares of Common Stock may again be optioned, granted or awarded if such action would cause an Incentive Stock Option to fail to qualify as an incentive stock option under Section 422 of the Code.

ARTICLE III. GRANTING OF AWARDS

3.1. *Award Agreement.* Each Award shall be evidenced by an Award Agreement. Award Agreements evidencing Awards intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code shall contain such terms and conditions as may be necessary to meet the applicable provisions of Section 162(m) of the Code. Award Agreements evidencing Incentive Stock Options shall contain such terms and conditions as may be necessary to meet the applicable provisions of Section 422 of the Code.

3.2. *Provisions Applicable to Section 162(m) Participants.*

(a) The Committee, in its discretion, may determine whether an Award is to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code.

(b) Notwithstanding anything in the Plan to the contrary, the Committee may grant any Award to a Section 162(m) Participant, including a Restricted Stock award, a Restricted Stock Unit award, a Dividend Equivalent award, a Deferred Stock award or a Stock Payment award, the restrictions with respect to which lapse upon the attainment of performance goals which are related to one or more of the Performance Criteria and any Award described in Article VIII that vests or becomes exercisable or payable upon the attainment of performance goals which are related to one or more of the Performance Criteria.

(c) To the extent necessary to comply with the performance-based compensation requirements of Section 162(m)(4)(C) of the Code, with respect to any Award granted under Articles VII and VIII which may be granted to one or more Section 162(m) Participants, no later than ninety (90) days following the commencement of any fiscal year in question or any other designated fiscal period or period of service (or such other time as may be required or permitted by Section 162(m) of the Code), the Committee shall, in writing, (i) designate one or more Section 162(m) Participants, (ii) select the Performance Criteria applicable to the fiscal year or other designated fiscal period or period of service, (iii) establish the various performance targets, in terms of an objective formula or standard, and amounts of such Awards, as applicable, which may be earned for such fiscal year or other designated fiscal period or period of service, and (iv) specify the relationship between Performance Criteria and the performance targets and the amounts of such Awards, as applicable, to be earned by

each Section 162(m) Participant for such fiscal year or other designated fiscal period or period of service. Following the completion of each fiscal year or other designated fiscal period or period of service, the Committee shall certify in writing whether the applicable performance targets have been achieved for such fiscal year or other designated fiscal period or period of service. In determining the amount earned by a Section 162(m) Participant, the Committee shall have the right to reduce (but not to increase) the amount payable at a given level of performance to take into account additional factors that the Committee may deem relevant to the assessment of individual or corporate performance for the fiscal year or other designated fiscal period or period of service.

(d) Furthermore, notwithstanding any other provision of the Plan, any Award which is granted to a Section 162(m) Participant and is intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code shall be subject to any additional limitations set forth in Section 162(m) of the Code (including any amendment to Section 162(m) of the Code) or any regulations or rulings issued thereunder that are requirements for qualification as performance-based compensation as described in Section 162(m)(4)(C) of the Code, and the Plan shall be deemed amended to the extent necessary to conform to such requirements.

3.3. *Limitations Applicable to Section 16 Persons.* Notwithstanding any other provision of the Plan, the Plan, and any Award granted or awarded to any individual who is then subject to Section 16 of the Exchange Act, shall be subject to any additional limitations set forth in any applicable exemptive rule under Section 16 of the Exchange Act (including any amendment to Rule 16b-3 of the Exchange Act) that are requirements for the application of such exemptive rule. To the extent permitted by applicable law, the Plan and Awards granted or awarded hereunder shall be deemed amended to the extent necessary to conform to such applicable exemptive rule.

3.4. *Consideration.* In consideration of the granting of an Award under the Plan, the Holder shall agree, in the Award Agreement, to remain in the employ of (or to consult for or to serve as an Independent Director of, as applicable) the Company or any Subsidiary for a period of at least one year (or such shorter period as may be fixed in the Award Agreement or by action of the Administrator following grant of the Award) after the Award is granted (or, in the case of an Independent Director, until the next annual meeting of stockholders of the Company).

3.5. *At-Will Employment.* Nothing in the Plan or in any Award Agreement hereunder shall confer upon any Holder any right to continue in the employ of, or as a Consultant for, the Company or any Subsidiary, or as a Director of the Company, or shall interfere with or restrict in any way the rights of the Company and any Subsidiary, which are hereby expressly reserved, to discharge any Holder at any time for any reason whatsoever, with or without cause, except to the extent expressly provided otherwise in a written employment agreement between the Holder and the Company and any Subsidiary.

3.6. *Foreign Holders.* Notwithstanding any provision of the Plan to the contrary, in order to comply with the laws in other countries in which the Company and any Subsidiary of the Company operate or have Employees, Independent Directors or Consultants, or in order to comply with the requirements of any foreign stock exchange or applicable laws, the Administrator, in its sole discretion, shall have the power and authority to: (a) determine which Subsidiaries shall be covered by the Plan; (b) determine which Employees, Independent Directors or Consultants outside the United States are eligible to participate in the Plan; (c) modify the terms and conditions of any Award granted to Employees, Independent Directors or Consultants outside the United States to comply with applicable foreign laws or listing requirements of any such foreign stock exchange; (d) establish subplans and modify exercise procedures and other terms and procedures, to the extent such actions may be necessary or advisable (any such subplans and/or modifications shall be attached to the Plan as appendices); provided, however, that no such subplans and/or modifications shall increase the share limitations contained in Article II or expand the classes of persons to whom Awards may be granted under the Plan; and (e) take any action, before or after an Award is made, that it deems advisable to obtain approval or comply with any necessary local governmental regulatory exemptions or approvals or listing requirements of any such foreign stock exchange. Notwithstanding the foregoing, the Administrator may not take any actions hereunder, and no Awards shall be granted, that would violate the Code, the Exchange Act, the Securities Act or any other securities law or governing statute or any other applicable law.

**ARTICLE IV.
GRANTING OF OPTIONS TO EMPLOYEES,
CONSULTANTS AND INDEPENDENT DIRECTORS**

4.1. *Eligibility.* Any Employee or Consultant selected by the Administrator pursuant to Section 4.4(a)(i) shall be eligible to be granted an Option. Each Independent Director of the Company shall be eligible to be granted Options at the times and in the manner set forth in Section 4.5.

4.2. *Disqualification for Stock Ownership.* No person may be granted an Incentive Stock Option under the Plan if such person, at the time the Incentive Stock Option is granted, owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or any then existing Subsidiary or parent corporation (within the meaning of Section 422 of the Code) unless such Incentive Stock Option conforms to the applicable provisions of Section 422 of the Code.

4.3. *Qualification of Incentive Stock Options.* No Incentive Stock Option shall be granted to any person who is not an Employee.

4.4. *Granting of Options to Employees and Consultants.*

(a) The Administrator shall from time to time, in its absolute discretion, and, subject to applicable limitations of the Plan:

(i) Determine which Employees are key Employees and select from among the key Employees or Consultants (including Employees or Consultants who have previously received Awards under the Plan) such of them as in its opinion should be granted Options;

(ii) Subject to the Award Limit, determine the number of shares to be subject to such Options granted to the selected key Employees or Consultants;

(iii) Subject to Section 4.3, determine whether such Options are to be Incentive Stock Options or Non-Qualified Stock Options and whether such Options are to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code; and

(iv) Determine the terms and conditions of such Options, consistent with the Plan; *provided, however,* that the terms and conditions of Options intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code shall include, but not be limited to, such terms and conditions as may be necessary to meet the applicable provisions of Section 162(m) of the Code.

(b) Upon the selection of a key Employee or Consultant to be granted an Option, the Administrator shall instruct the Secretary of the Company to issue the Option and may impose such conditions on the grant of the Option as it deems appropriate.

(c) Any Incentive Stock Option granted under the Plan may be modified by the Administrator, with the consent of the Holder, to disqualify such Option from treatment as an "incentive stock option" under Section 422 of the Code.

4.5. *Granting of Options to Independent Directors.* The Board shall from time to time, in its absolute discretion, and subject to applicable limitations of the Plan:

(a) Select from among the Independent Directors (including Independent Directors who have previously received Options under the Plan) such of them as in its opinion should be granted Options;

(b) Subject to the Award Limit, determine the number of shares to be subject to such Options granted to the selected Independent Directors; and

(c) Determine the terms and conditions of such Options, consistent with the Plan.

All the foregoing Option grants authorized by this Section 4.5 are subject to stockholder approval of the Plan.

4.6. *Options in Lieu of Cash Compensation.* Options may be granted under the Plan to Employees and Consultants in lieu of cash bonuses which would otherwise be payable to such Employees and Consultants, and to Independent Directors in lieu of directors' fees which would otherwise be payable to such Independent Directors, pursuant to such policies which may be adopted by the Administrator from time to time.

**ARTICLE V.
TERMS OF OPTIONS**

5.1. *Option Price.* The price per share of the shares subject to each Option granted to Employees, Independent Directors and Consultants shall be set by the Administrator; *provided, however*, that:

(a) In the case of Options intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code, such price shall not be less than 100% of the Fair Market Value of a share of Common Stock on the date the Option is granted;

(b) In the case of Incentive Stock Options such price shall not be less than 100% of the Fair Market Value of a share of Common Stock on the date the Option is granted (or the date the Option is modified, extended or renewed for purposes of Section 424(h) of the Code);

(c) In the case of Incentive Stock Options granted to an individual then owning (within the meaning of Section 424(d) of the Code) more than 10% of the total combined voting power of all classes of stock of the Company or any Subsidiary or parent corporation thereof (within the meaning of Section 422 of the Code), such price shall not be less than 110% of the Fair Market Value of a share of Common Stock on the date the Option is granted (or the date the Option is modified, extended or renewed for purposes of Section 424(h) of the Code); and

(d) In the case of Non-Qualified Stock Options, such price shall not be less than 100% of the Fair Market Value of a share of Common Stock on the date the Option is granted.

5.2. *Option Term.* The term of an Option granted to an Employee, Independent Director or Consultant shall be set by the Administrator in its discretion; *provided, however*, that the term shall not be more than ten (10) years from the date the Option is granted, or five (5) years from the date the Option is granted if the Option is an Incentive Stock Option granted to an individual then owning (within the meaning of Section 424(d) of the Code) more than 10% of the total combined voting power of all classes of stock of the Company or any Subsidiary Corporation or parent corporation thereof (as defined in Section 424(e) of the Code). Except as limited by requirements of Section 422 of the Code and regulations and rulings thereunder applicable to Incentive Stock Options, the Administrator may extend the term of any outstanding Option in connection with any Termination of Employment, Termination of Directorship or Termination of Consultancy of the Holder, or amend any other term or condition of such Option relating to such a Termination of Employment, Termination of Directorship or Termination of Consultancy.

5.3. *Option Vesting.*

(a) The period during which the right to exercise, in whole or in part, an Option granted to an Employee, Independent Director or a Consultant vests in the Holder shall be set by the Administrator and the Administrator may determine that an Option may not be exercised in whole or in part for a specified period after it is granted; *provided, however*, that, unless the Administrator otherwise provides in the terms of the Award Agreement or otherwise, no Option shall be exercisable by any Holder who is then subject to Section 16 of the Exchange Act within the period ending six months and one day after the date the Option is granted. At any time after grant of an Option, the Administrator may, in its sole and absolute discretion and subject to whatever terms and conditions it selects, accelerate the period during which an Option granted to an Employee, Independent Director or Consultant vests.

(b) No portion of an Option granted to an Employee, Independent Director or Consultant which is unexercisable at Termination of Employment, Termination of Directorship or Termination of Consultancy, as applicable, shall thereafter become exercisable, except as may be otherwise provided

by the Administrator either in the Award Agreement or by action of the Administrator following the grant of the Option.

(c) To the extent that the aggregate fair market value of stock with respect to which "incentive stock options" (within the meaning of Section 422 of the Code, but without regard to Section 422(d) of the Code) are exercisable for the first time by a Holder during any calendar year under the Plan, and all other plans of the Company and any Subsidiary or parent corporation thereof, within the meaning of Section 424 of the Code, exceeds \$100,000, the Options shall be treated as Non-Qualified Stock Options to the extent required by Section 422 of the Code. The rule set forth in the preceding sentence shall be applied by taking Options and other "incentive stock options" into account in the order in which they were granted. For purposes of this Section 5.3(c), the fair market value of stock shall be determined as of the time the Option or other "incentive stock options" with respect to such stock is granted.

5.4. *Substitute Awards.* Notwithstanding the foregoing provisions of this Article V to the contrary, in the case of an Option that is a Substitute Award, the price per share of the shares subject to such Option may be less than the Fair Market Value per share on the date of grant, *provided*, that the excess of: (a) the aggregate Fair Market Value (as of the date such Substitute Award is granted) of the shares subject to the Substitute Award, over (b) the aggregate exercise price thereof, does not exceed the excess of: (c) the aggregate fair market value (as of the time immediately preceding the transaction giving rise to the Substitute Award, such fair market value to be determined by the Committee) of the shares of the predecessor entity that were subject to the grant assumed or substituted for by the Company, over (d) the aggregate exercise price of such shares.

5.5. *Substitution of Stock Appreciation Rights.* The Administrator may provide in the Award Agreement evidencing the grant of an Option that the Administrator, in its sole discretion, shall have the right to substitute a Stock Appreciation Right for such Option at any time prior to or upon exercise of such Option, subject to the provisions of Section 9.2; *provided*, that such Stock Appreciation Right shall be exercisable with respect to the same number of shares of Common Stock for which such substituted Option would have been exercisable and at the Option exercise price per share.

ARTICLE VI. EXERCISE OF OPTIONS

6.1. *Partial Exercise.* An exercisable Option may be exercised in whole or in part. However, an Option shall not be exercisable with respect to fractional shares and the Administrator may require that, by the terms of the Option, a partial exercise be with respect to a minimum number of shares.

6.2. *Manner of Exercise.* All or a portion of an exercisable Option shall be deemed exercised upon delivery of all of the following to the Secretary of the Company, or such other person or entity designated by the Board, or his, her or its office, as applicable:

(a) A written notice complying with the applicable rules established by the Administrator stating that the Option, or a portion thereof, is exercised. The notice shall be signed by the Holder or other person then entitled to exercise the Option or such portion of the Option;

(b) Such representations and documents as the Administrator, in its absolute discretion, deems necessary or advisable to effect compliance with all applicable provisions of the Securities Act and any other federal or state securities laws or regulations. The Administrator may, in its absolute discretion, also take whatever additional actions it deems appropriate to effect such compliance including, without limitation, placing legends on share certificates and issuing stop-transfer notices to agents and registrars;

(c) In the event that the Option shall be exercised pursuant to Section 12.1 by any person or persons other than the Holder, appropriate proof of the right of such person or persons to exercise the Option; and

(d) Full cash payment to the Secretary of the Company for the shares with respect to which the Option, or portion thereof, is exercised. However, the Administrator may, in its discretion, (i) allow payment, in whole or in part, through the delivery of shares of Common Stock which have been owned by the Holder for at least six months, duly endorsed for transfer to the Company with a Fair Market Value on the date of delivery equal to the aggregate exercise price of the Option or exercised portion thereof; (ii) allow payment, in whole or in part, through the surrender of shares of Common Stock then issuable upon exercise of the Option having a Fair Market Value on the date of Option exercise equal to the aggregate exercise price of the Option or exercised portion thereof; (iii) allow payment, in whole or in part, through the delivery of property of any kind which constitutes good and valuable consideration; (iv) allow payment, in whole or in part, through the delivery of a notice that the Holder has placed a market sell order with a broker with respect to shares of Common Stock then issuable upon exercise of the Option, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to the Company in satisfaction of the Option exercise price, *provided*, that payment of such proceeds is then made to the Company upon settlement of such sale; or (v) allow payment through any combination of the consideration provided in the foregoing paragraphs (i), (ii), (iii) and (iv); *provided, however*, that the payment in the manner prescribed in the preceding paragraphs shall not be permitted to the extent that the Administrator determines that payment in such manner shall result in an extension or maintenance of credit, an arrangement for the extension of credit, or a renewal or an extension of credit in the form of a personal loan to or for any Director or executive officer of the Company that is prohibited by Section 13(k) of the Exchange Act or other applicable law.

6.3. *Conditions to Issuance of Stock Certificates.* The Company shall not be required to issue or deliver any certificate or certificates for shares of stock purchased upon the exercise of any Option or portion thereof prior to fulfillment of all of the following conditions:

(a) The admission of such shares to listing on all stock exchanges on which such class of stock is then listed;

(b) The completion of any registration or other qualification of such shares under any state or federal law, or under the rulings or regulations of the Securities and Exchange Commission or any other governmental regulatory body which the Administrator shall, in its absolute discretion, deem necessary or advisable;

(c) The obtaining of any approval or other clearance from any state or federal governmental agency which the Administrator shall, in its absolute discretion, determine to be necessary or advisable;

(d) The lapse of such reasonable period of time following the exercise of the Option as the Administrator may establish from time to time for reasons of administrative convenience; and

(e) The receipt by the Company of full payment for such shares, including payment of any applicable withholding tax, which in the discretion of the Administrator may be in the form of consideration used by the Holder to pay for such shares under Section 6.2(d).

6.4. *Rights as Stockholders.* Holders shall not be, nor have any of the rights or privileges of, stockholders of the Company in respect of any shares purchasable upon the exercise of any part of an Option unless and until certificates representing such shares have been issued by the Company to such Holders.

6.5. *Ownership and Transfer Restrictions.* The Administrator, in its absolute discretion, may impose such restrictions on the ownership and transferability of the shares purchasable upon the exercise of an Option as it deems appropriate. Any such restriction shall be set forth in the respective Award Agreement and may be referred to on the certificates evidencing such shares. The Holder shall give the Company prompt notice of any disposition of shares of Common Stock acquired by exercise of an Incentive Stock Option within (a) two years from the date of granting (including the date the Option is modified, extended or renewed for purposes of Section 424(h) of the Code) such Option to such Holder, or (b) one year after the transfer of such shares to such Holder.

6.6. *Additional Limitations on Exercise of Options.* Holders may be required to comply with any timing or other restrictions with respect to the settlement or exercise of an Option, including a window-period limitation, as may be imposed in the discretion of the Administrator.

ARTICLE VII. AWARD OF RESTRICTED STOCK

7.1. *Eligibility.* Subject to the Award Limit, Restricted Stock may be awarded to any Employee whom the Administrator determines is a key Employee, or any Independent Director or any Consultant, whom the Administrator determines should receive such an Award.

7.2. *Award of Restricted Stock.*

(a) The Administrator may from time to time, in its absolute discretion:

(i) Determine which Employees are key Employees, and select from among the key Employees, Independent Directors or Consultants (including Employees, Independent Directors or Consultants who have previously received other Awards under the Plan) such of them as in its opinion should be awarded Restricted Stock; and

(ii) Determine the purchase price, if any, and other terms and conditions applicable to such Restricted Stock, consistent with the Plan.

(b) The Administrator shall establish the purchase price, if any, and form of payment for Restricted Stock; *provided, however*, that such purchase price shall be no less than the par value of the Common Stock to be purchased, unless otherwise permitted by applicable state law. In all cases, legal consideration shall be required for each issuance of Restricted Stock.

(c) Upon the selection of an Employee, Independent Director or Consultant to be awarded Restricted Stock, the Administrator shall instruct the Secretary of the Company to issue such Restricted Stock and may impose such conditions on the issuance of such Restricted Stock as it deems appropriate.

7.3. *Rights as Stockholders.* Subject to Section 7.4, upon delivery of the shares of Restricted Stock to the escrow holder pursuant to Section 7.7, the Holder shall have, unless otherwise provided by the Administrator, all the rights of a stockholder with respect to said shares, subject to the restrictions in his or her Award Agreement, including the right to receive all dividends and other distributions paid or made with respect to the shares; *provided, however*, that, in the discretion of the Administrator, any dividends or distributions with respect to the Common Stock shall be subject to the restrictions set forth in Section 7.4.

7.4. *Restriction.* All shares of Restricted Stock issued under the Plan (including any shares received by Holders thereof with respect to shares of Restricted Stock as a result of stock dividends, stock splits or any other form of recapitalization) shall, in the terms of each individual Award Agreement, be subject to such restrictions as the Administrator shall provide, which restrictions may include, without limitation, restrictions concerning voting rights and transferability and restrictions based on duration of employment, directorship or consultancy with the Company, or any Subsidiary, or any parent thereof, Company

performance and individual performance, or any one or more of the Performance Criteria or other specific performance criteria determined appropriate by the Administrator; *provided, however*, that, unless the Administrator otherwise provides in the terms of the Award Agreement or otherwise, no share of Restricted Stock granted to a person subject to Section 16 of the Exchange Act shall be sold, assigned or otherwise transferred until at least six months and one day have elapsed from the date on which the Restricted Stock was issued; and, *provided, further*, that, except with respect to shares of Restricted Stock granted to Section 162(m) Participants, by action taken after the Restricted Stock is issued, the Administrator may, on such terms and conditions as it may determine to be appropriate, remove any or all of the restrictions imposed by the terms of the Award Agreement. Restricted Stock may not be sold or encumbered until all restrictions are terminated or expire. If no consideration was paid by the Holder upon issuance, a Holder's rights in unvested Restricted Stock shall lapse, and such Restricted Stock shall be surrendered to the Company without consideration, upon Termination of Employment, Termination of Directorship, or Termination of Consultancy, as applicable; *provided, however*, that the Administrator in its sole and absolute discretion may provide that such rights shall not lapse in the event of a Termination of Employment, Termination of Directorship or Termination of Consultancy, as applicable, following a "change of ownership or control" (within the meaning of Treasury Regulation Section 1.162-27(e)(2)(v) or any successor regulation thereto) of the Company or because of the Holder's death or disability; and, *provided, further*, except with respect to shares of Restricted Stock granted to Section 162(m) Participants that is intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code, the Administrator in its sole and absolute discretion may provide that no such lapse or surrender shall occur in the event of a Termination of Employment, Termination of Directorship, or Termination of Consultancy, as applicable, without cause or following any Change in Control or because of the Holder's retirement, or otherwise.

7.5. *Repurchase of Restricted Stock.* The Administrator shall provide in the terms of each individual Award Agreement that the Company shall have the right to repurchase from the Holder the Restricted Stock then subject to restrictions under the Award Agreement immediately upon a Termination of Employment, Termination of Directorship, or Termination of Consultancy, as applicable, at a cash price per share equal to the price paid by the Holder for such Restricted Stock; *provided, however*, that the Administrator in its sole and absolute discretion may provide that no such right of repurchase shall exist in the event of a Termination of Employment, Termination of Directorship or Termination of Consultancy, as applicable, following a "change of ownership or control" (within the meaning of Treasury Regulation Section 1.162-27(e)(2)(v) or any successor regulation thereto) of the Company or because of the Holder's death or disability; and, *provided, further*, that, except with respect to shares of Restricted Stock granted to Section 162(m) Participants that is intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code, the Administrator in its sole and absolute discretion may provide that no such right of repurchase shall exist in the event of a Termination of Employment, Termination of Directorship, or Termination of Consultancy, as applicable, without cause or following any Change in Control or because of the Holder's retirement, or otherwise.

7.6. *Escrow.* The Secretary of the Company or such other escrow holder as the Administrator may appoint shall retain physical custody of each certificate representing Restricted Stock until all of the restrictions imposed under the Award Agreement with respect to the shares evidenced by such certificate expire or shall have been removed.

7.7. *Legend.* In order to enforce the restrictions imposed upon shares of Restricted Stock hereunder, the Administrator shall cause a legend or legends to be placed on certificates representing all shares of Restricted Stock that are still subject to restrictions under Award Agreements, which legend or legends shall make appropriate reference to the conditions imposed thereby.

7.8. *Section 83(b) Election.* If a Holder makes an election under Section 83(b) of the Code, or any successor section thereto, to be taxed with respect to the Restricted Stock as of the date of transfer of the

Restricted Stock rather than as of the date or dates upon which the Holder would otherwise be taxable under Section 83(a) of the Code, the Holder shall deliver a copy of such election to the Company immediately after filing such election with the Internal Revenue Service.

**ARTICLE VIII.
DIVIDEND EQUIVALENTS, DEFERRED STOCK, STOCK PAYMENTS,
RESTRICTED STOCK UNITS**

8.1. *Eligibility.* Subject to the Award Limit, one or more Dividend Equivalent awards, Deferred Stock awards, Stock Payment awards, and/or Restricted Stock Unit awards may be granted to any Employee whom the Administrator determines is a key Employee, or any Independent Director or any Consultant, whom the Administrator determines should receive such an Award.

8.2. *Dividend Equivalents.*

(a) Any key Employee, Independent Director or Consultant selected by the Administrator may be granted Dividend Equivalents based on the dividends declared on the Common Stock, to be credited as of dividend payment dates, during the period between the date a Stock Appreciation Right, Deferred Stock award, or Restricted Stock Unit award is granted, and the date such Stock Appreciation Right, Deferred Stock award, or Restricted Stock Unit award vests, is exercised, is distributed, terminates or expires, as determined by the Administrator. Such Dividend Equivalents shall be converted to cash or additional shares of Common Stock by such formula and at such time and subject to such limitations as may be determined by the Administrator.

(b) Any Holder of an Option who is an Employee, Independent Director or Consultant selected by the Administrator may be granted Dividend Equivalents based on the dividends declared on the Common Stock, to be credited as of dividend payment dates, during the period between the date an Option is granted, and the date such Option vests, is exercised, terminates or expires, as determined by the Administrator. Such Dividend Equivalents shall be converted to cash or additional shares of Common Stock by such formula and at such time and subject to such limitations as may be determined by the Administrator.

(c) Dividend Equivalents granted with respect to Options intended to be qualified performance-based compensation for purposes of Section 162(m) of the Code shall be payable, with respect to pre-exercise periods, regardless of whether such Option is subsequently exercised.

8.3. *Stock Payments.* Any key Employee, Independent Director or Consultant selected by the Administrator may receive Stock Payments in the manner determined from time to time by the Administrator. The number of shares shall be determined by the Administrator and may be based upon the Performance Criteria or other specific performance criteria determined appropriate by the Administrator, determined on the date such Stock Payment is made or on any date thereafter.

8.4. *Deferred Stock.* Any key Employee, Independent Director or Consultant selected by the Administrator may be granted an award of Deferred Stock in the manner determined from time to time by the Administrator. The number of shares of Deferred Stock shall be determined by the Administrator and may be based upon the Performance Criteria or other specific performance criteria determined to be appropriate by the Administrator, in each case on a specified date or dates or over any period or periods determined by the Administrator. Common Stock underlying a Deferred Stock award shall not be issued until the Deferred Stock award shall have vested, pursuant to a vesting schedule or performance criteria set by the Administrator. The Administrator shall specify the distribution dates applicable to each Deferred Stock award which shall be no earlier than the vesting dates or events of the award and may be determined at the election of the Employee, Independent Director or Consultant. Unless otherwise provided by the Administrator, a Holder of Deferred Stock shall have no rights as a Company stockholder

with respect to such Deferred Stock until such time as the Award has vested and the Common Stock underlying the Award has been issued.

8.5. *Restricted Stock Units.* Any key Employee, Independent Director or Consultant selected by the Administrator may be granted an award of Restricted Stock Units in the manner determined from time to time by the Administrator. The Administrator is authorized to make awards of Restricted Stock Units in such amounts and subject to such terms and conditions as determined by the Administrator. The Administrator shall specify the date or dates on which the Restricted Stock Units shall become fully vested and nonforfeitable, and may specify such conditions to vesting as it deems appropriate, and may specify that such Restricted Stock Units become fully vested and nonforfeitable pursuant to the satisfaction of one or more Performance Goals or other specific performance goals as the Administrator determines to be appropriate at the time of the grant of the Restricted Stock Units or thereafter, in each case on a specified date or dates or over any period or periods determined by the Administrator. The Administrator shall specify the distribution dates applicable to each award of Restricted Stock Units which shall be no earlier than the vesting dates or events of the award and may be determined at the election of the Employee, Independent Director or Consultant. On the distribution dates, the Company shall issue to the Participant one unrestricted, fully transferable share of Common Stock for each Restricted Stock Unit distributed. The Administrator shall specify the purchase price, if any, to be paid by the Employee, Independent Director or Consultant to the Company for such shares of Common Stock to be distributed pursuant to the Restricted Stock Unit award.

8.6. *Term.* The term of a Dividend Equivalent award, Deferred Stock award, Stock Payment award and/or Restricted Stock Unit award shall be set by the Administrator in its discretion.

8.7. *Exercise or Purchase Price.* The Administrator may establish the exercise or purchase price of shares of Deferred Stock, shares distributed as a Stock Payment award or shares distributed pursuant to a Restricted Stock Unit award; *provided, however*, that such price shall not be less than the par value of a share of Common Stock, unless otherwise permitted by applicable state law.

8.8. *Exercise upon Termination of Employment, Termination of Consultancy or Termination of Directorship.* A Dividend Equivalent award, Deferred Stock award, Stock Payment award and/or Restricted Stock Unit award is exercisable or distributable only while the Holder is an Employee, Consultant or Independent Director, as applicable; *provided, however*, that the Administrator in its sole and absolute discretion may provide that the Dividend Equivalent award, Deferred Stock award, Stock Payment award and/or Restricted Stock Unit award may be exercised or distributed subsequent to a Termination of Employment, Termination of Directorship or Termination of Consultancy following a "change of control or ownership" (within the meaning of Section 1.162-27(e)(2)(v) or any successor regulation thereto) of the Company.

8.9. *Form of Payment.* Payment of the amount determined under Section 8.2 above shall be in cash, in Common Stock or a combination of both, as determined by the Administrator. To the extent any payment under this Article VIII is effected in Common Stock, it shall be made subject to satisfaction of all provisions of Section 6.3.

ARTICLE IX. STOCK APPRECIATION RIGHTS

9.1. *Grant of Stock Appreciation Rights.* A Stock Appreciation Right may be granted to any key Employee, Independent Director or Consultant selected by the Administrator. A Stock Appreciation Right may be granted: (a) in connection and simultaneously with the grant of an Option, (b) with respect to a previously granted Option, or (c) independent of an Option. A Stock Appreciation Right shall be subject to such terms and conditions not inconsistent with the Plan as the Administrator shall impose and shall be evidenced by an Award Agreement.

9.2. *Coupled Stock Appreciation Rights.*

(a) A Coupled Stock Appreciation Right ("*CSAR*") shall be related to a particular Option and shall be exercisable only when and to the extent the related Option is exercisable.

(b) A *CSAR* may be granted to the Holder for no more than the number of shares subject to the simultaneously or previously granted Option to which it is coupled.

(c) A *CSAR* shall entitle the Holder (or other person entitled to exercise the Option pursuant to the Plan) to surrender to the Company unexercised a portion of the Option to which the *CSAR* relates (to the extent then exercisable pursuant to its terms) and to receive from the Company in exchange therefor an amount determined by multiplying the difference obtained by subtracting the Option exercise price from the Fair Market Value of a share of Common Stock on the date of exercise of the *CSAR* by the number of shares of Common Stock with respect to which the *CSAR* shall have been exercised, subject to any limitations the Administrator may impose.

9.3. *Independent Stock Appreciation Rights.*

(a) An Independent Stock Appreciation Right ("*ISAR*") shall be unrelated to any Option and shall have a term set by the Administrator provided, however, that the term shall not be more than ten (10) years from the date the *ISAR* is granted. An *ISAR* shall be exercisable in such installments as the Administrator may determine. An *ISAR* shall cover such number of shares of Common Stock as the Administrator may determine; provided, however, that unless the Administrator otherwise provides in the terms of the *ISAR* or otherwise, no *ISAR* granted to a person subject to Section 16 of the Exchange Act shall be exercisable until at least six months have elapsed from (but excluding) the date on which the Option was granted. The exercise price per share of Common Stock subject to each *ISAR* shall be set by the Administrator; provided, that such exercise price per share shall not be less than 100% of the Fair Market Value of a share of Common Stock on the date the *ISAR* is granted. An *ISAR* is exercisable only while the Holder is an Employee, Independent Director or Consultant; provided, that the Administrator may determine that the *ISAR* may be exercised subsequent to Termination of Employment, Termination of Directorship or Termination of Consultancy without cause, or following a Change in Control of the Company, or because of the Holder's retirement, death or disability, or otherwise.

(b) An *ISAR* shall entitle the Holder (or other person entitled to exercise the *ISAR* pursuant to the Plan) to exercise all or a specified portion of the *ISAR* (to the extent then exercisable pursuant to its terms) and to receive from the Company an amount determined by multiplying the difference obtained by subtracting the exercise price per share of the *ISAR* from the Fair Market Value of a share of Common Stock on the date of exercise of the *ISAR* by the number of shares of Common Stock with respect to which the *ISAR* shall have been exercised, subject to any limitations the Administrator may impose.

9.4. *Payment and Limitations on Exercise.*

(a) Payment of the amounts determined under Section 9.2(c) and 9.3(b) above shall be in cash, in Common Stock (based on its Fair Market Value as of the date the Stock Appreciation Right is exercised) or a combination of both, as determined by the Administrator. To the extent such payment is effected in Common Stock it shall be made subject to satisfaction of all provisions of Section 6.3 above pertaining to Options.

(b) Holders of Stock Appreciation Rights may be required to comply with any timing or other restrictions with respect to the settlement or exercise of a Stock Appreciation Right, including a window-period limitation, as may be imposed in the discretion of the Administrator.

**ARTICLE X.
COMPLIANCE WITH SECTION 409A OF THE CODE**

10.1. *Awards subject to Code Section 409A.* Any Award that constitutes, or provides for, a deferral of compensation subject to Section 409A of the Code (a "Section 409A Award") shall satisfy the requirements of Section 409A of the Code and this Article X, to the extent applicable. The Award Agreement with respect to a Section 409A Award shall incorporate the terms and conditions required by Section 409A of the Code and this Article X.

10.2. *Distributions under a Section 409A Award.*

(a) Subject to subsection (b), any shares of Common Stock, cash or other property or amounts to be paid or distributed upon the grant, issuance, vesting, exercise or payment of a Section 409A Award shall be distributed in accordance with the requirements of Section 409A(a)(2) of the Code, and shall not be distributed earlier than:

(i) the Holder's separation from service, as determined by the Secretary of the Treasury,

(ii) the date the Holder becomes disabled,

(iii) the Holder's death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the Award Agreement at the date of the deferral of such compensation,

(v) to the extent provided by the Secretary of the Treasury, a change in the ownership or effective control of the Company or a Subsidiary, or in the ownership of a substantial portion of the assets of the Company or a Subsidiary, or

(vi) the occurrence of an unforeseeable emergency with respect to the Holder.

(b) In the case of a Holder who is a specified employee, the requirement of paragraph (a)(i) shall be met only if the distributions with respect to the Section 409A Award may not be made before the date which is six months after the Holder's separation from service (or, if earlier, the date of the Holder's death). For purposes of this subsection (b), a Holder shall be a specified employee if such Holder is a key employee (as defined in Section 416(i) of the Code without regard to paragraph (5) thereof) of a corporation any stock of which is publicly traded on an established securities market or otherwise, as determined under Section 409A(a)(2)(B)(i) of the Code and the Treasury Regulations thereunder.

(c) The requirement of paragraph (a)(vi) shall be met only if, as determined under Treasury Regulations under Section 409A(a)(2)(B)(ii) of the Code, the amounts distributed with respect to the unforeseeable emergency do not exceed the amounts necessary to satisfy such unforeseeable emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such unforeseeable emergency is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Holder's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(d) For purposes of this Section, the terms specified therein shall have the respective meanings ascribed thereto under Section 409A of the Code and the Treasury Regulations thereunder.

10.3. *Prohibition on Acceleration of Benefits.* The time or schedule of any distribution or payment of any shares of Common Stock, cash or other property or amounts under a Section 409A Award shall not be accelerated, except as otherwise permitted under Section 409A(a)(3) of the Code and the Treasury Regulations thereunder.

10.4. *Elections under Section 409A Awards.*

(a) Any deferral election provided under or with respect to an Award to any Employee, Independent Director or Consultant, or to the Holder of a Section 409A Award, shall satisfy the requirements of Section 409A(a)(4)(B) of the Code, to the extent applicable, and, except as otherwise permitted under paragraph (i) or (ii), any such deferral election with respect to compensation for services performed during a taxable year shall be made not later than the close of the preceding taxable year, or at such other time as provided in Treasury Regulations.

(i) In the case of the first year in which an Employee, Independent Director or Consultant, or the Holder, becomes eligible to participate in the Plan, any such deferral election may be made with respect to services to be performed subsequent to the election with thirty (30) days after the date the Employee, Independent Director or Consultant, or the Holder, becomes eligible to participate in the Plan, as provided under Section 409A(a)(4)(B)(ii) of the Code.

(ii) In the case of any performance-based compensation based on services performed by an Employee, Independent Director or Consultant, or the Holder, over a period of at least twelve (12) months, any such deferral election may be made no later than six months before the end of the period, as provided under Section 409A(a)(4)(B)(iii) of the Code.

(b) In the event that a Section 409A Award permits, under a subsequent election by the Holder of such Section 409A Award, a delay in a distribution or payment of any shares of Common Stock, cash or other property or amounts under such Section 409A Award, or a change in the form of distribution or payment, such subsequent election shall satisfy the requirements of Section 409A(a)(4)(C) of the Code, and:

(i) such subsequent election may not take effect until at least twelve (12) months after the date on which the election is made,

(ii) in the case such subsequent election relates to a distribution or payment not described in Section 10.2(a)(ii), (iii) or (vi), the first payment with respect to such election may be deferred for a period of not less than five years from the date such distribution or payment otherwise would have been made, and

(iii) in the case such subsequent election relates to a distribution or payment described in Section 10.2(a)(iv), such election may not be made less than twelve (12) months prior to the date of the first scheduled distribution or payment under Section 10.2(a)(iv).

10.5. *Compliance in Form and Operation.* A Section 409A Award, and any election under or with respect to such Section 409A Award, shall comply in form and operation with the requirements of Section 409A of the Code and the Treasury Regulations thereunder.

**ARTICLE XI.
ADMINISTRATION**

11.1. *Compensation Committee.* The Compensation Committee (or another committee or a subcommittee of the Board assuming the functions of the Committee under the Plan) shall consist solely of two or more Independent Directors appointed by and holding office at the pleasure of the Board, each of whom is both a "non-employee director" as defined by Rule 16b-3 and an "outside director" for purposes of Section 162(m) of the Code. Appointment of Committee members shall be effective upon acceptance of appointment. Committee members may resign at any time by delivering written notice to the Board. Vacancies in the Committee may be filled by the Board.

11.2. *Duties and Powers of Committee.* It shall be the duty of the Committee to conduct the general administration of the Plan in accordance with its provisions. The Committee shall have the power to interpret the Plan and the Award Agreements, and to adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith, to interpret, amend or revoke any such rules and to amend any Award Agreement provided that the rights or obligations of the Holder of the Award that is the subject of any such Award Agreement are not affected adversely. Any such grant or award under the Plan need not be the same with respect to each Holder. Any such interpretations and rules with respect to Incentive Stock Options shall be consistent with the provisions of Section 422 of the Code. In its absolute discretion, the Board may at any time and from time to time exercise any and all rights and duties of the Committee under the Plan except with respect to matters which under Rule 16b-3 or Section 162(m) of the Code, or any regulations or rules issued thereunder, are required to be determined in the sole discretion of the Committee. Notwithstanding the foregoing, the full Board, acting by a majority of its members in office, shall conduct the general administration of the Plan with respect to Awards granted to Independent Directors.

11.3. *Majority Rule; Unanimous Written Consent.* The Committee shall act by a majority of its members in attendance at a meeting at which a quorum is present or by a memorandum or other written instrument signed by all members of the Committee.

11.4. *Compensation; Professional Assistance; Good Faith Actions.* Members of the Committee shall receive such compensation, if any, for their services as members as may be determined by the Board. All expenses and liabilities which members of the Committee incur in connection with the administration of the Plan shall be borne by the Company. The Committee may, with the approval of the Board, employ attorneys, consultants, accountants, appraisers, brokers or other persons. The Committee, the Company and the Company's officers and Directors shall be entitled to rely upon the advice, opinions or valuations of any such persons. All actions taken and all interpretations and determinations made by the Committee or the Board in good faith shall be final and binding upon all Holders, the Company and all other interested persons. No members of the Committee or Board shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or Awards, and all members of the Committee and the Board shall be fully protected by the Company in respect of any such action, determination or interpretation.

11.5. *Delegation of Authority to Grant Awards.* The Committee may, but need not, delegate from time to time some or all of its authority to grant Awards under the Plan to a committee consisting of one or more members of the Committee or of one or more officers of the Company, to the extent permitted by applicable state law; *provided, however*, that the Committee may not delegate its authority to grant Awards to individuals: (a) who are subject on the date of the grant to the reporting rules under Section 16(a) of the Exchange Act, (b) who are Section 162(m) Participants, or (c) who are officers of the Company who are delegated authority by the Committee hereunder. Any delegation hereunder shall be subject to the restrictions and limits that the Committee specifies at the time of such delegation of authority and may be rescinded at any time by the Committee. At all times, any committee appointed under this Section 11.5 shall serve in such capacity at the pleasure of the Committee.

ARTICLE XII. MISCELLANEOUS PROVISIONS

12.1. *Transferability of Awards.*

(a) Except as otherwise provided in Section 12.1(b):

(i) No Award under the Plan may be sold, pledged, assigned or transferred in any manner other than by will or the laws of descent and distribution or, subject to the consent of the Administrator, pursuant to a DRO, unless and until such Award has been exercised, or the shares

underlying such Award have been issued, and all restrictions applicable to such shares have lapsed;

(ii) No Option, Restricted Stock award, Deferred Stock award, Stock Appreciation Right, Dividend Equivalent award, Stock Payment award, or Restricted Stock Unit award, or any interest or right therein, shall be liable for the debts, contracts or engagements of the Holder or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law by judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect, except to the extent that such disposition is permitted by the preceding sentence; and

(iii) During the lifetime of the Holder, only the Holder may exercise an Option or other Award (or any portion thereof) granted to him under the Plan, unless it has been disposed of pursuant to a DRO; after the death of the Holder, any exercisable portion of an Option or other Award may, prior to the time when such portion becomes unexercisable under the Plan or the applicable Award Agreement, be exercised by his personal representative or by any person empowered to do so under the deceased Holder's will or under the then applicable laws of descent and distribution.

(b) Notwithstanding Section 12.1(a), the Administrator, in its sole discretion, may determine to permit a Holder to transfer a Non-Qualified Stock Option to any one or more Permitted Transferees (as defined below), subject to the following terms and conditions: (i) a Non-Qualified Stock Option transferred to a Permitted Transferee shall not be assignable or transferable by the Permitted Transferee other than by will or the laws of descent and distribution; (ii) any Non-Qualified Stock Option which is transferred to a Permitted Transferee shall continue to be subject to all the terms and conditions of the Non-Qualified Stock Option as applicable to the original Holder (other than the ability to further transfer the Non-Qualified Stock Option); and (iii) the Holder and the Permitted Transferee shall execute any and all documents requested by the Administrator, including, without limitation documents to (A) confirm the status of the transferee as a Permitted Transferee, (B) satisfy any requirements for an exemption for the transfer under applicable federal and state securities laws and (C) evidence the transfer. For purposes of this Section 12.1(b), "*Permitted Transferee*" shall mean, with respect to a Holder, any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships, any person sharing the Holder's household (other than a tenant or employee), a trust in which these persons (or the Holder) control the management of assets, and any other entity in which these persons (or the Holder) own more than fifty percent of the voting interests, or any other transferee specifically approved by the Administrator after taking into account any state or federal tax or securities laws applicable to transferable Non-Qualified Stock Options.

12.2. *Amendment, Suspension or Termination of the Plan.* Except as otherwise provided in this Section 12.2, the Plan may be wholly or partially amended or otherwise modified, suspended or terminated at any time or from time to time by the Board. However, without approval of the Company's stockholders given within twelve (12) months before or after the action by the Board, no action of the Board may, except as provided in Section 12.3, (i) increase the limits imposed in Section 2.1 on the maximum number of shares which may be issued under the Plan, or the maximum number of shares which may be granted or issued as Restricted Stock awards, Restricted Stock Unit awards, Dividend Equivalent awards, Deferred Stock awards, or Stock Payment awards, (ii) expand the classes of persons to whom Awards may be granted under the Plan, or (iii) decrease the exercise price of any outstanding Option or Stock Appreciation Right granted under the Plan. No amendment, suspension or termination of the Plan shall,

without the consent of the Holder, alter or impair any rights or obligations under any Award theretofore granted or awarded, unless the Award itself otherwise expressly so provides. No Awards may be granted or awarded during any period of suspension or after termination of the Plan, and in no event may any Award be granted under the Plan after the first to occur of the following events:

- (a) The expiration of ten (10) years from the date this second amendment and restatement of the Plan is adopted by the Board; or
- (b) The expiration of ten (10) years from the date this second amendment and restatement of the Plan is approved by the Company's stockholders under Section 12.4.

12.3. Changes in Common Stock or Assets of the Company, Acquisition or Liquidation of the Company and Other Corporate Events.

(a) Subject to Section 12.3(e), in the event that the Administrator determines that any dividend or other distribution (whether in the form of cash, Common Stock, other securities or other property), recapitalization, reclassification, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, liquidation, dissolution, or sale, transfer, exchange or other disposition of all or substantially all of the assets of the Company, or exchange of Common Stock or other securities of the Company, issuance of warrants or other rights to purchase Common Stock or other securities of the Company, or other similar corporate transaction or event affects the Common Stock, then the Administrator shall equitably adjust any or all of the following in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan or with respect to an Award:

- (i) The number and kind of shares of Common Stock (or other securities or property) with respect to which Awards may be granted or awarded (including, but not limited to, adjustments of the limitations in Section 2.1 on the maximum number and kind of shares which may be issued under the Plan, and the maximum number and kind of shares which may be granted or issued as Restricted Stock awards, Restricted Stock Unit awards, Dividend Equivalent awards, Deferred Stock awards or Stock Payment awards, adjustments of the Award Limit, and adjustments of the manner in which shares subject to Full Value Awards will be counted);
- (ii) The number and kind of shares of Common Stock (or other securities or property) subject to outstanding Awards; and
- (iii) The grant or exercise price with respect to any Award.

(b) Subject to Sections 12.3(c) and 12.3(e), in the event of any transaction or event described in Section 12.3(a) or any unusual or nonrecurring transactions or events affecting the Company, any affiliate of the Company, or the financial statements of the Company or any affiliate, or of changes in applicable laws, regulations or accounting principles, the Administrator, in its sole and absolute discretion, and on such terms and conditions as it deems appropriate, either by the terms of the Award or by action taken prior to the occurrence of such transaction or event and either automatically or upon the Holder's request, is hereby authorized to take any one or more of the following actions whenever the Administrator determines that such action is appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan or with respect to any Award under the Plan, to facilitate such transactions or events or to give effect to such changes in laws, regulations or principles:

- (i) To provide for either the purchase of any such Award for an amount of cash equal to the amount that could have been attained upon the exercise of such Award or realization of the Holder's rights had such Award been currently exercisable or payable or fully vested or the

replacement of such Award with other rights or property selected by the Administrator in its sole discretion;

(ii) To provide that the Award cannot vest, be exercised or become payable after such event;

(iii) To provide that such Award shall be exercisable as to all shares covered thereby, notwithstanding anything to the contrary in Section 5.3 or the provisions of such Award;

(iv) To provide that such Award be assumed by the successor or survivor corporation, or a parent or subsidiary thereof, or shall be substituted for by similar options, rights or awards covering the stock of the successor or survivor corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number and kind of shares and prices; and

(v) To make adjustments in the number and type of shares of Common Stock (or other securities or property) subject to outstanding Awards, and/or in the terms and conditions of (including the grant, exercise or purchase price), and the criteria included in, outstanding options, rights and awards and options, rights and awards which may be granted in the future.

(vi) To provide that, for a specified period of time prior to such event, the restrictions imposed under an Award Agreement upon some or all shares of Restricted Stock, Restricted Stock Units or Deferred Stock may be terminated, and, in the case of Restricted Stock, some or all shares of such Restricted Stock may cease to be subject to repurchase under Section 7.5 or forfeiture under Section 7.4 after such event.

(c) Notwithstanding any other provision of the Plan, in the event of a Change in Control, each outstanding Award shall remain outstanding, or shall be assumed or an equivalent award substituted by the successor corporation, or a parent or subsidiary of the successor corporation. In the event that the successor corporation, or a parent or subsidiary of the successor corporation, with respect to the Change in Control transaction refuses to assume or substitute for the Award, the Holder shall have the right to exercise the Award as to all of the shares subject thereto, including shares as to which such Award otherwise would not be exercisable, and the Holder shall have the right to vest in, and received a distribution of, such Award, with respect to all of the shares subject thereto. If an Award becomes exercisable in lieu of assumption or substitution by the successor corporation, or a parent or subsidiary corporation, with respect to a Change in Control transaction, the Administrator shall notify the Holder that the Award shall be fully exercisable for a period of not less than fifteen (15) days from the date of such notice prior to the Change in Control transaction, and the Award shall terminate upon the expiration of such period. For purposes of this Section 12.3(c), the Award shall be assumed, or an equivalent award shall be substituted for such Award, if, following the Change in Control transaction, the Award or substituted award confers on the Holder the right to purchase or receive, for each share subject to the Award immediately prior to the Change in Control transaction, the consideration (whether in stock, cash, or other securities or property, or a combination thereof) received or to be received for each share of Common Stock in the Change in Control transaction on the effective date of the Change in Control transaction (and if holders of shares of Common Stock were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding shares of Common Stock); *provided, however*, that, if such consideration received in the Change in Control transaction was not solely common stock of the successor corporation or its parent, the Administrator may, with the consent of the successor corporation or its parent, provide for the consideration to be received upon the exercise, vesting or distribution of the assumed Award or substituted award, for each share subject to the Award, to be solely common stock of the successor corporation or its parent equal in fair market value to the per share consideration received by the holders of Common Stock in the Change in Control transaction.

(d) Subject to Sections 12.3(e), 3.2 and 3.3, the Administrator may, in its discretion, include such further provisions and limitations in any Award or Award Agreement as it may deem equitable and in the best interests of the Company.

(e) With respect to Awards which are granted to Section 162(m) Participants and are intended to qualify as performance-based compensation under Section 162(m)(4)(C), no adjustment or action described in this Section 12.3 or in any other provision of the Plan shall be authorized to the extent that such adjustment or action would cause such Award to fail to so qualify under Section 162(m)(4)(C), or any successor provisions thereto. No adjustment or action described in this Section 12.3 or in any other provision of the Plan shall be authorized to the extent that such adjustment or action would cause the Plan to violate Section 422(b)(1) of the Code. Furthermore, no such adjustment or action shall be authorized to the extent such adjustment or action would result in short-swing profits liability under Section 16 or violate the exemptive conditions of Rule 16b-3 unless the Administrator determines that the Award is not to comply with such exemptive conditions. The number of shares of Common Stock subject to any Award shall always be rounded to the next whole number.

(f) Notwithstanding the foregoing, in the event that the Company becomes a party to a transaction that is intended to qualify for "pooling of interests" accounting treatment and, but for one or more of the provisions of this Plan or any Award Agreement would so qualify, then this Plan and any Award Agreement shall be interpreted so as to preserve such accounting treatment, and to the extent that any provision of the Plan or any Award Agreement would disqualify the transaction from pooling of interests accounting treatment (including, if applicable, an entire Award Agreement), then such provision shall be null and void. All determinations to be made in connection with the preceding sentence shall be made by the independent accounting firm whose opinion with respect to "pooling of interests" treatment is required as a condition to the Company's consummation of such transaction.

(g) The existence of the Plan, the Award Agreement and the Awards granted hereunder shall not affect or restrict in any way the right or power of the Company or the shareholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other change in the Company's capital structure or its business, any merger or consolidation of the Company, any issue of stock or of options, warrants or rights to purchase stock or of bonds, debentures, preferred or prior preference stocks whose rights are superior to or affect the Common Stock or the rights thereof or which are convertible into or exchangeable for Common Stock, or the dissolution or liquidation of the company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

(h) No action shall be taken under this Section 12.3 which shall cause an Award to fail to comply with Section 409A of the Code or the Treasury Regulations thereunder, to the extent applicable to such Award.

12.4. *Approval of Plan by Stockholders.* The Plan will be submitted for the approval of the Company's stockholders within twelve (12) months after the date of the Board's initial adoption of the Plan. Awards may be granted or awarded prior to such stockholder approval, *provided*, that such Awards shall not be exercisable nor shall such Awards vest prior to the time when the Plan is approved by the stockholders, and *provided further*, that if such approval has not been obtained at the end of said twelve-month period, all Awards previously granted or awarded under the Plan shall thereupon be canceled and become null and void. In addition, if the Board determines that Awards other than Options or Stock Appreciation Rights which may be granted to Section 162(m) Participants should continue to be eligible to qualify as performance-based compensation under Section 162(m)(4)(C) of the Code, the Performance Criteria must be disclosed to and approved by the Company's stockholders no later than the first

stockholder meeting that occurs in the fifth year following the year in which the Company's stockholders previously approved the Plan, as amended and restated to include the Performance Criteria.

12.5. *Tax Withholding.* The Company shall be entitled to require payment in cash or deduction from other compensation payable to each Holder of any sums required by federal, state or local tax law to be withheld with respect to the grant, issuance, vesting, exercise or payment of any Award. The Administrator may in its discretion and in satisfaction of the foregoing requirement allow such Holder to elect to have the Company withhold shares of Common Stock otherwise issuable under such Award (or allow the return of shares of Common Stock) having a Fair Market Value equal to the sums required to be withheld. Notwithstanding any other provision of the Plan, the number of shares of Common Stock which may be withheld with respect to the issuance, vesting, exercise or payment of any Award (or which may be repurchased from the Holder of such Award within six months after such shares of Common Stock were acquired by the Holder from the Company) in order to satisfy the Holder's federal and state income and payroll tax liabilities with respect to the issuance, vesting, exercise or payment of the Award shall be limited to the number of shares which have a Fair Market Value on the date of withholding or repurchase equal to the aggregate amount of such liabilities based on the minimum statutory withholding rates for federal and state tax income and payroll tax purposes that are applicable to such supplemental taxable income.

12.6. *Prohibition on Repricing.* Subject to Section 12.3, the Administrator shall not, without the approval of the stockholders of the Company, authorize the amendment of any outstanding Award to reduce its price per share. Furthermore, no Award shall be canceled and replaced with the grant of an Award having a lesser price per share without the further approval of stockholders of the Company.

12.7. *Forfeiture Provisions.* Pursuant to its general authority to determine the terms and conditions applicable to Awards and the Award Agreements under the Plan, the Administrator shall have the right to provide, in the terms of Awards made under the Plan, or to require a Holder to agree by separate written instrument, that: (a)(i) any proceeds, gains or other economic benefit actually or constructively received by the Holder upon any receipt or exercise of the Award, or upon the receipt or resale of any Common Stock underlying the Award, must be paid to the Company, and (ii) the Award shall terminate and any unexercised portion of the Award (whether or not vested) shall be forfeited, if (b)(i) a Termination of Employment, Termination of Directorship or Termination of Consultancy occurs prior to a specified date, or within a specified time period following receipt or exercise of the Award, or (ii) the Holder at any time, or during a specified time period, engages in any activity in competition with the Company, or which is inimical, contrary or harmful to the interests of the Company, as further defined by the Administrator or (iii) the Holder incurs a Termination of Employment, Termination of Directorship or Termination of Consultancy for "cause" (as such term is defined in the sole and absolute discretion of the Committee, or as set forth in a written agreement relating to such Award between the Company and the Holder).

12.8. *Effect of Plan upon Options and Compensation Plans.* The adoption of the Plan shall not affect any other compensation or incentive plans in effect for the Company or any Subsidiary. Nothing in the Plan shall be construed to limit the right of the Company: (a) to establish any other forms of incentives or compensation for Employees, Directors or Consultants of the Company or any Subsidiary, or (b) to grant or assume options or other rights or awards otherwise than under the Plan in connection with any proper corporate purpose including but not by way of limitation, the grant or assumption of options in connection with the acquisition by purchase, lease, merger, consolidation or otherwise, of the business, stock or assets of any corporation, partnership, limited liability company, firm or association.

12.9. *Compliance with Laws.* The Plan, the granting and vesting of Awards under the Plan and the issuance and delivery of shares of Common Stock and the payment of money under the Plan or under Awards granted or awarded hereunder are subject to compliance with all applicable federal and state laws, rules and regulations (including but not limited to state and federal securities law and federal margin

requirements) and to such approvals by any listing, regulatory or governmental authority as may, in the opinion of counsel for the Company, be necessary or advisable in connection therewith. Any securities delivered under the Plan shall be subject to such restrictions, and the person acquiring such securities shall, if requested by the Company, provide such assurances and representations to the Company as the Company may deem necessary or desirable to assure compliance with all applicable legal requirements. To the extent permitted by applicable law, the Plan and Awards granted or awarded hereunder shall be deemed amended to the extent necessary to conform to such laws, rules and regulations.

12.10. *Titles.* Titles are provided herein for convenience only and are not to serve as a basis for interpretation or construction of the Plan.

12.11. *Governing Law.* The Plan and any agreements hereunder shall be administered, interpreted and enforced under the internal laws of the State of California without regard to conflicts of laws thereof.

* * *

I hereby certify that the foregoing amendment and restatement of the Plan was duly adopted by the Board of Directors of Watson Pharmaceuticals, Inc. on May 7, 2010.

Executed on this 7th day of May 2010.

By: _____
/s/ DAVID A. BUCHEN
David A. Buchen
Secretary

* * *

I hereby certify that the Plan was previously approved by the stockholders of Watson Pharmaceuticals, Inc. on May 4, 2007.

Executed on this 7th day of May 2010.

By: _____
/s/ DAVID A. BUCHEN
David A. Buchen
Secretary

**Watson Pharmaceuticals, Inc.
Subsidiaries of the Company
As of February 18, 2011**

<u>Name</u>	<u>Jurisdiction of Incorporation</u>
Watson Laboratories, Inc.	Nevada
Watson Laboratories, Inc.	New York
Watson Laboratories, Inc.	Delaware
Watson Laboratories, Inc.	Connecticut
Watson Pharma, Inc.	Delaware
Watson Pharmaceuticals (New Jersey), Inc.	Delaware
Andrx Corporation	Delaware
Watson Manufacturing Services, Inc.	Delaware
Watson Cobalt Holdings, LLC	Delaware
Cobalt Laboratories, Inc.	Delaware
Watson Pharma Private Limited	India
Nicobrand Limited	United Kingdom
The Rugby Group, Inc.	New York
Valmed Pharmaceutical, Inc.	New York
Watson Laboratories, Inc.	Florida
Anda, Inc.	Florida
Anda Pharmaceuticals, Inc.	Florida
Watson Management Corporation	Florida
Watson Therapeutics, Inc.	Florida
Makoff R&D Laboratories, Inc.	California
R&D Ferlecit Capital Resources, Inc.	California
Watson Pharma Holding S.a.r.l.	Luxembourg
Watson Pharma S.a.r.l.	Luxembourg
Robin Hood Holdings, Ltd.	Malta
Arrow Pharmaceutical Holdings, Ltd.	Malta
Arrow Supplies, Ltd.	Malta
Arrow International, Ltd.	Malta
Arrow Group ApS	Denmark
Arrow Scandinavia AB	Sweden
Seeker Investments, Ltd.	British Virgin Islands
Gaja Investments BV	Holland
Arrow Generiques SAS	France
Selamine, Ltd.	Ireland
Arrow Poland SA	Poland
Eden Biopharma Group, Ltd.	United Kingdom
Breath, Ltd.	United Kingdom
Arrow Generics, Ltd.	United Kingdom
Arrow No 7, Ltd.	United Kingdom
Arrow Pharmaceuticals, Inc.	Canada
Cobalt Pharmaceuticals, Inc.	Canada
Arrow Farmaceutica, Ltda.	Brazil
Spirit Pharmaceuticals (Proprietary), Ltd.	Australia
Juta Pharma GmbH	Germany
Scriptpharm Holdings (Proprietary), Ltd.	South Africa

Consent of Independent Registered Public Accounting Firm

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-70943, 333-53312, 333-105816, 333-161404) and Form S-8 (Nos. 333-05737, 333-24577, 333-37733, 333-70933, 333-38596, 333-45650, 333-53334, 333-61844, 333-61842, 333-102285, 333-111032, 33-144039) of Watson Pharmaceuticals, Inc. of our report dated February 21, 2011 relating to the financial statements, financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

PricewaterhouseCoopers LLP Orange County, CA February 21, 2011

**Certification of Chief Executive Officer
Pursuant to Rule 13a-14(a) Under the Securities Exchange Act
of 1934**

I, Paul M. Bisaro, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Watson Pharmaceuticals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 21, 2011

By:

/s/ PAUL M. BISARO
Paul M. Bisaro
President and Chief Executive Officer
(Principal Executive Officer)

**Certification of Chief Financial Officer
Pursuant to Rule 13a-14(a) Under the Securities Exchange Act
of 1934**

I, R. Todd Joyce, Senior Vice President — Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Watson Pharmaceuticals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 21, 2011

By:

/s/ **R. TODD JOYCE**

R. Todd Joyce
Senior Vice President — Chief Financial Officer
(Principal Financial Officer)

**Certification of Chief Executive Officer
Pursuant to 18 U.S.C. of Section 1350, as Created by
Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned officer of Watson Pharmaceuticals, Inc. (the "Company"), hereby certifies, to such officer's knowledge, that:

(i) the Annual Report on Form 10-K of the Company for the year ended December 31, 2010 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 21, 2011

By:

/s/ PAUL M. BISARO

Paul M. Bisaro
President and Chief Executive Officer
(Principal Executive Officer)

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

**Certification of Chief Financial Officer
Pursuant to 18 U.S.C. of Section 1350, as Created by
Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned officer of Watson Pharmaceuticals, Inc. (the "Company"), hereby certifies, to such officer's knowledge, that:

(i) the Annual Report on Form 10-K of the Company for the year ended December 31, 2010 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 21, 2011

By: _____ /s/ **R. TODD JOYCE**
R. Todd Joyce
Senior Vice President — Chief Financial Officer
(Principal Financial Officer)

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.