CITIZENS & NORTHERN CORP
Form 4
November 19, 2013

FORM 4

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

(Print or Type Responses)

1. Name and Address of Reporting Person *
BEARDSLEE DENNIS

(Last) (First) (Middle)

54 CHESTNUT STREET

(Street)

TROY, PA 16947

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
CITIZENS & NORTHERN CORP [CZNC]

3. Date of Earliest Transaction (Month/Day/Year)
11/15/2013

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer
(Check all applicable)
__X__ Director
_____ 10% Owner
_____ Officer (give title below)
_____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	11/15/2013		J(1)	V	132	A	$ 20.535	11,412	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
BEARDSLEE DENNIS 54 CHESTNUT STREET TROY, PA 16947	X			

Signatures

Teri L. Mitchell for Dennis F. Beardslee under Power of Attorney dated 7/23/09.	11/19/2013
**Signature of Reporting Person	Date

Explanation of Responses:

***** If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

****** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Dividend of 11/15/13 posted to D/R Account

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number.) interest income and (3) other non-operating, non-cash income.

CODES

In March 2003, the Company issued $575.0 million of CODES. The CODES, which are convertible into shares of Watson s common stock upon the occurrence of certain events, are due in March 2023, with interest payments due semi-annually in March and September at an effective annual interest rate of 2.1%, excluding changes in the fair value of the contingent interest derivative. At December 31, 2008 and 2007, the unamortized discount for the CODES was $0.3 million and $0.6 million, respectively.

The CODES are convertible into Watson s common stock at a conversion price of approximately $40.05 per share (subject to adjustments upon certain events such as (i) stock splits or dividends, (ii) material stock distributions or reclassifications, (iii) distribution of stock purchase rights at less than current market rates or (iv) a distribution of assets or common stock to our shareholders or subsidiaries). The CODES may be converted, at the option of the holders, prior to maturity under any of the following circumstances:

during any quarterly conversion period (period from and including the thirtieth trading day in a fiscal quarter to, but not including, the thirtieth trading day in the immediately following fiscal quarter) if the closing sale price per share of Watson s common stock for a period of at least 20 trading days during the 30 consecutive trading-day period ending on the first day of such conversion period is more than 125% ($50.06) of the conversion price in effect on that thirtieth day;

on or before March 15, 2018, during the five business-day period following any 10 consecutive trading-day period in which the daily average trading price for the CODES for such ten-day period was less than 105% of the average conversion value for the debentures during that period. This conversion feature represents an embedded derivative. However, based on the de minimis value associated with this feature, no value has been assigned at issuance and at December 31, 2008;

during any period, following the earlier of (a) the date the CODES are rated by both Standard & Poor s Rating Services and Moody s Investor Services, Inc., and (b) April 21, 2003, when the long-term credit rating assigned to the CODES by either Standard & Poor s or Moody s (or any successors to these entities) is lower than BB or Ba3 , respectively, or when either of these rating agencies does not have a rating then assigned to the CODES for any reason, including any withdrawal or suspension of a rating assigned to the CODES. This conversion feature represents an embedded derivative. However, based on the de minimis value associated with this feature, no value has been assigned at issuance and at December 31, 2008;

if the CODES have been called for redemption; or

upon the occurrence of specified corporate transactions.

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company may redeem some or all of the CODES for cash, on or after March 20, 2008, for a price equal to 100% of the principal amount of the CODES plus accrued and unpaid interest (including contingent interest) to, but excluding, the redemption date.

The CODES contain put options which may require the Company to repurchase for cash all or a portion of the CODES on March 15 of 2010, 2015 and 2018 at a repurchase price equal to 100% of the principal amount of the CODES plus any accrued and unpaid interest (including contingent interest) to, but excluding, the date of repurchase.

In addition, the holders of the CODES have the right to receive contingent interest payments during any six-month period from March 15 to September 14 and from September 15 to March 14, commencing on September 15, 2003, if the average trading price of the CODES for the five trading days ending on the second trading day immediately preceding the relevant six-month period equals 120% or more of the principal amount of the CODES. The interest rate used to calculate the contingent interest is the greater of 5% of the Company s then-current estimated per annum borrowing rate for senior non-convertible fixed-rate debt with a maturity date and other terms comparable to that of the CODES or 0.33% per annum. This contingent interest payment feature is an embedded derivative and has been recorded separately in the Consolidated Balance Sheets. The initial fair value assigned to the embedded derivative was $1.9 million, which is recorded as a discount to the CODES. Changes to the fair value of this embedded derivative are reflected as an adjustment to interest expense. The current value of the embedded derivative was $12,000 and $48,900 at December 31, 2008 and 2007, respectively.

Annual Debt Maturities

At December 31, 2008, annual maturities of long-term debt were as follows: $0.0 million in 2009, $0.0 million in 2010, $250.0 million in 2011, $0.0 million in 2012, $0.0 million in 2013 and $575.0 million thereafter. Amounts represent total anticipated cash payments on our CODES and 2006 Credit Facility assuming existing debt maturity schedules. Any early settlement of our CODES through redemption or conversion privileges, as defined under the terms of the CODES, or additional prepayment of our 2006 Credit Facility would change the timing of principal amounts due or could reduce the total amount due under the Company s long-term debt obligations.

Interest Rate Swaps

During 2007 the Company entered into an interest rate swap agreement to convert floating-rate debt to fixed-rate debt on a notional amount of $200.0 million. The interest rate swap instruments involved agreements to receive a floating rate and pay a fixed rate, at specified intervals, calculated on the agreed-upon notional amount. The differentials paid or received on interest rate swap agreements were recognized as adjustments to interest expense in the period. These interest swap agreements were entered into on September 17, 2007 and expired in January 2009.

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 Income Taxes

The Company s income before provision for income taxes was generated from U.S. and international operations as follows:

	Years Ended December 31,		
	2008	2007	2006
	(In thousands)		
Earnings (loss) before income taxes:			
U.S	$ 353,167	$ 216,824	$ (417,145)
Foreign	5,146	7,460	6,196
Earnings (loss) before income taxes	$ 358,313	$ 224,284	$ (410,949)

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

	Years Ended December 31,		
	2008	2007	2006
	(In thousands)		
Current provision:			
Federal	$ 101,346	$ 79,270	$ 53,315
State	14,312	9,994	3,853
Foreign	763	240	1,576
Total current provision	116,421	89,504	58,744
Deferred provision (benefit):			
Federal	3,142	(7,519)	(25,492)
State	371	(644)	1,946
Foreign		1,913	(1,142)
Total deferred benefit (provision)	3,513	(6,250)	(24,688)
Total provision for income taxes	$ 119,934	$ 83,254	$ 34,056

During 2008, the Company reached agreement with the IRS related to the Exam. The resolution of the Exam represents a large portion of the changes in the amount of the liability for uncertain tax benefits including the amount of the liability that would impact the effective rate and the amount accrued for interest and penalties. As a result, the

tax provision for the year ended December 31, 2008 reflects a non-recurring benefit of $7.8 million for taxes and interest.

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. The benefits recorded were $0.2 million, $1.0 million, and $0.9 million for the years ended December 31, 2008, 2007, and 2006, respectively.

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Years Ended December 31,		
	2008	2007	2006
Federal income tax at statutory rates	35.0%	35.0%	(35.0)%
State income taxes, net of federal benefit	2.8%	3.0%	0.9%
Favorable tax authorities outcome	(2.2)%		(1.3)%
Charitable contributions	(0.5)%	(1.2)%	(0.4)%
Valuation allowance	(0.7)%	2.0%	1.6%
Sale of Somerset	(1.2)%		
IPR&D			42.4%
Other	0.3%	(1.7)%	0.1%
Effective income tax rate	33.5%	37.1%	8.3%

During 2008, the Company sold its interest in the Somerset joint venture to Mylan. The benefit to the effective tax rate of (1.2)% relates to the recognition of the deferred tax that could not previously be recognized because it was not foreseeable that the deferred tax asset for the investment would reverse in the foreseeable future.

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:

	December 31,	
	2008	2007
	(In thousands)	
Benefits from net operating loss carryforwards	$ 2,016	$ 6,475
Benefits from tax credit carryforwards		3,481
Differences in financial statement and tax accounting for:		
Inventories, receivables and accruals	98,643	105,347
Property, equipment and intangible assets	(101,755)	(119,109)
Deferred revenue	14,685	20,474
Convertible debt	(67,808)	(54,286)
Share-based compensation	9,046	4,479
Other	26,442	23,633
Total deferred tax liability, gross	(18,731)	(9,506)
Less valuation allowance	(8,127)	(12,493)

Total deferred tax liability, net	$ (26,858)	$ (21,999)

The Company had net operating loss (NOL) carryforwards at December 31, 2008 of approximately $304.0 million for state income tax purposes and capital loss carryforwards of $1.8 million which begin to expire in 2009 and 2013, respectively. Additionally, due to restrictions imposed as a result of ownership changes to acquired subsidiaries, the amount of NOL carryforwards available to offset future taxable income is subject to limitation. The annual NOL utilization may be further limited if additional changes in ownership occur. A valuation allowance has been established due to the uncertainty of realizing certain deferred tax assets relating to certain impaired investments and capital loss carryovers.

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred income taxes have not been provided on the undistributed earnings of certain of the Company s foreign subsidiaries of approximately $18.0 million and $12.0 million as of December 31, 2008 and 2007, 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.

Adoption of FIN 48

On January 1, 2007, the Company adopted the provisions of FIN 48. Differences between the amount recognized in the consolidated financial statements prior to the adoption of FIN 48 and the amounts reported as a result of adoption have been accounted for as a cumulative effect adjustment recorded to the January 1, 2007 retained earnings balance. The adoption of FIN 48 decreased the January 1, 2007, balance of retained earnings by $2.9 million. In addition, upon adoption the Company reclassified tax reserves for which a cash tax payment is not expected in the next twelve months from current to non-current liabilities.

At December 31, 2008 and 2007, the liability for income tax associated with uncertain tax positions was $61.2 million and $71.2 million, respectively. This amount is reduced for timing differences and amounts primarily arising from business combinations which, if recognized, would be recorded to goodwill. As of December 31, 2008, the net amount of $35.9 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 (in thousands) for the years ended December 31,:

	2008	2007
	(In thousands)	
Opening balance	$ 71,181	$ 69,220
Additions based on tax positions related to the current period	5,045	6,636
Additions for tax positions of prior periods	7,801	34,316
Reductions for tax positions of prior periods	(11,942)	(33,046)
Settlements	(10,831)	(5,945)
Ending balance	$ 61,254	$ 71,181

The Company s continuing practice is to recognize interest and penalties related to uncertain tax positions in tax expense. At December 31, 2008 and 2007, the Company had accrued $3.9 million (net of tax benefit of $2.3 million) and $6.2 million (net of tax benefit of $3.6 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. In the normal course of business the Company is subject to examination by taxing authorities. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 2000. In 2008,

the IRS began examining the Company s 2004, 2005, and 2006 tax years. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company believes its reserves for income taxes represent the likely outcome. The Company adjusts these reserves, as well as the related interest, in light of changing facts and circumstances.

The Company anticipates the total amount of the liability for unrecognized tax benefits may change due to the settlement of audits, the quantification of which is uncertain at this time.

NOTE 11 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,

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

conversion and voting rights, terms and prices of redemptions and liquidation preferences without vote or action by the stockholders. Watson has not issued any preferred stock.

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, 2008, the Company had reserved 8.0 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 thousands):

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding, December 31, 2005	11,194	$ 36.76		
Granted	883	26.42		
Exercised	(313)	18.73		
Cancelled	(779)	37.60		
Outstanding, December 31, 2006	10,985	36.39		
Granted	596	30.60		
Exercised	(616)	26.25		
Cancelled	(1,146)	36.81		
Outstanding, December 31, 2007	9,819	36.62		
Granted				
Exercised	(308)	27.42		
Cancelled	(2,260)	39.51		
Outstanding, December 31, 2008	7,251	$ 36.11	4.3	$ 990
Vested and expected to vest at December 31, 2008	7,027	$ 36.32	4.2	$ 953

Options exercisable at December 31, 2008	6,043	$ 37.46	3.7	$	735

As of December 31, 2008, the Company had $3.6 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 1.6 years. Total intrinsic value of options exercised for the year ended December 31, 2008 and 2007 was $0.7 million and $3.0 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

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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. 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, 2008 is presented below (shares and aggregate intrinsic value in thousands):

	Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Restricted shares outstanding at December 31, 2007	1,036	$ 30.70	2.0	$ 31,810
Granted	897	27.63		24,777
Vested	(141)	27.49		(3,874)
Cancelled	(225)	29.67		(6,674)
Restricted shares outstanding at December 31, 2008	1,567	$ 29.38	1.8	$ 46,039

As of December 31, 2008, the Company had $18.0 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 1.8 years.

Stock Repurchases

During the years ended December 31, 2008 and 2007, we repurchased approximately 30,000 and 57,000 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 for total consideration of $0.9 million and $1.8 million, respectively.

NOTE 12 Operating Segments

Watson has three reportable operating segments: Generic, Brand and Distribution. The Generic segment includes off-patent pharmaceutical products that are therapeutically equivalent to proprietary products. The Brand segment includes the Company s lines of Specialty Products and Nephrology products. Watson has aggregated its Brand product lines in a single segment because of similarities in regulatory environment, methods of distribution and types of customer. This segment includes patent-protected products and certain trademarked off-patent products that Watson sells and markets as Brand pharmaceutical products. The Company sells its Brand and Generic products primarily to

pharmaceutical wholesalers, drug distributors and chain drug stores in the U.S. Following the Andrx Acquisition, a third operating segment was added representing the Anda distribution business. The Distribution segment distributes generic pharmaceutical products and select brand pharmaceutical products manufactured by third parties to independent pharmacies, pharmacy chains, pharmacy buying groups and physicians offices in the U.S. Sales are principally generated through an in-house telemarketing staff and through internally developed ordering systems. The Distribution segment operating results are included in Watson results since the date of the Andrx Acquisition and exclude sales by Anda of Watson Generic and Brand products, which are included in their respective segment results.

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

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 net revenues, gross profit and contribution. Segment contribution represents segment gross profit less direct R&D expenses and selling and marketing expenses. The Company does not report total assets, capital expenditures, corporate general and administrative expenses, amortization, IPR&D charges, 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 gross profit and segment contribution information for the Company s Generic, Brand and Distribution segments consisted of the following:

	Years Ended December 31,		
	2008	**2007**	**2006**
Generic Segment			
Product sales	$ 1,403,975	$ 1,408,885	$ 1,501,251
Other	70,358	92,991	15,725
Net revenues	1,474,333	1,501,876	1,516,976
Cost of revenue	883,832	917,863	1,059,234
Gross profit	590,501	584,013	457,742
Gross margin	40.1%	38.9%	30.2%
Research and development	119,218	102,426	83,551
Selling and marketing	55,230	55,350	52,882
Generic Contribution	**$ 416,053**	**$ 426,237**	**$ 321,309**
Contibution margin	28.2%	28.4%	21.2%
Brand Segment			
Product sales	$ 397,025	$ 375,202	$ 354,070

Other	57,953	53,520	15,402
Net revenues	454,978	428,722	369,472
Cost of revenue	107,079	99,913	92,184
Gross profit	347,899	328,809	277,288
Gross margin	76.5%	76.7%	75.0%
Research and development	50,904	42,367	47,472
Selling and marketing	118,198	108,061	112,258
Brand Contribution	**$ 178,797**	**$ 178,381**	**$ 117,558**
Contibution margin	39.3%	41.6%	31.8%
Distribution Segment			
Product sales	$ 606,190	$ 566,053	$ 92,796
Other			
Net revenues	606,190	566,053	92,796
Cost of revenue	511,911	486,980	82,065
Gross profit	94,279	79,073	10,731
Gross margin	15.6%	14.0%	11.6%
Research and development			
Selling and marketing	59,514	52,023	8,409
Distribution Contribution	**$ 34,765**	**$ 27,050**	**$ 2,322**
Contibution margin	5.7%	4.8%	2.5%
Total Segment Contribution	**$ 629,615**	**$ 631,668**	**$ 441,189**

Corporate general and administrative	190,486	205,717	131,511
Amortization	80,690	176,409	163,710
In-process research and development			497,800
Loss (gain) on asset sales and impairments	311	(6,118)	70,264
Operating income (loss)	$ 358,128	$ 255,660	$ (422,096)

Table of Contents

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 therapeutic categories for the years ended December 31,:

	2008	2007	2006
		(In thousands)	
Central nervous system	$ 795,718	$ 772,064	$ 705,787
Hormones and synthetic substitutes	525,682	551,175	459,415
Cardiovascular	245,539	312,921	218,205
Nephrology	174,435	170,719	173,783
Gastrointestinal	129,950	73,652	26,937
Other	535,866	469,609	363,990
	$ 2,407,190	$ 2,350,140	$ 1,948,117

NOTE 13 Business Restructuring Charges

During the first quarter of 2008, the Company announced efforts to reduce its cost structure with the planned closure of its manufacturing facilities in Carmel, New York and its distribution center in Brewster, New York. Activity related to our business restructuring and facility rationalization activities for the period ended December 31, 2008 consisted of the following:

	Charged to Expense	Cash Payments	Non-cash Adjustments	Accrual Balance at December 31, 2008
		(In thousands)		
Cost of sales				
Severance and retention	$ 15,471	$ (1,762)	$	$ 13,709
Product transfer costs	4,315	(3,599)		716
Facility decommission costs	858	(727)		131
Accelerated depreciation	7,406		(7,406)	
	28,050	(6,088)	(7,406)	14,556
Operating expenses				
Research and development	1,445	(770)		675
Selling, general and administrative	941	(97)		844

	2,386	(867)		1,519
Total restructuring charges	$ 30,436	$ (6,955)	$ (7,406)	$ 16,075

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

While the final closing date will depend on a number of factors, we anticipate these facilities will close by the end of 2010. The Company expects to incur pre-tax costs associated with the planned closures of approximately $60.0 to $70.0 million which includes accelerated depreciation expense of $25.0 to $30.0 million, severance, retention, relocation and other employee related costs of approximately $25.0 to $30.0 million and product transfer costs of approximately $8.0 to $12.0 million.

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 Fair Value Measurement

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

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

Financial assets and liabilities measured at fair value or disclosed at fair value on a recurring basis as at December 31, 2008 consisted of the following (in thousands):

	Fair Value Measurements as at December 31, 2008 Using:			
	Total	**Level 1**	**Level 2**	**Level 3**
Marketable securities	$ 13,202	$ 13,202	$	$
Investments	153	153		
Derivative liabilities	12		12	

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. The fair value of derivative liabilities, consisting of an embedded derivative related to the CODES, are determined based on inputs that can be derived from information available in publicly quoted markets. Unrealized gains or losses on marketable securities and investments are recorded in accumulated other comprehensive (loss) income. Changes in the fair value of the embedded derivative related to the CODES are reflected as an adjustment to interest expense.

NOTE 15 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 2008, 2007 and 2006 was $19.0 million, $18.1 million and $11.5 million, respectively.

At December 31, 2008, future minimum lease payments under all non-cancelable operating leases are approximately $18.1 million in 2009, $15.6 million in 2010, $14.3 million in 2011, $8.7 million in 2012 $5.3 million in 2013 and $26.2 million thereafter.

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 $10.6 million, $8.6 million and $6.9 million in the years ended December 31, 2008, 2007 and 2006, 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 payment is probable.

Cipro® Litigation. Beginning in July 2000, a number of suits were filed against Watson, The Rugby Group, Inc. (Rugby) and other company affiliates in various state and federal courts alleging claims under various federal and state competition and consumer protection laws. Several plaintiffs have filed amended complaints and motions seeking class certification. Approximately 42 cases had been filed against Watson, Rugby and other Watson entities. Twenty-two of these actions have been consolidated in the U.S. District Court for the Eastern District of New York (*In re: Ciprofloxacin Hydrochloride Antitrust Litigation, MDL Docket No. 001383*). On May 20, 2003, the court hearing the consolidated action granted Watson s motion to dismiss and made rulings limiting the theories under which plaintiffs can seek recovery against Rugby and the other defendants. On March 31, 2005, the court hearing the consolidated action granted summary judgment in favor of the defendants on all of plaintiffs claims, denied the plaintiffs motions for class certification, and directed the clerk of the court to close the case. On May 7, 2005, three groups of plaintiffs from the consolidated action (the direct purchaser plaintiffs, the indirect purchaser plaintiffs and plaintiffs Rite Aid and CVS) filed notices of appeal in the United States Court of Appeals for the Second Circuit, appealing, among other things, the May 20, 2003 order dismissing Watson and the March 31, 2005 order granting summary judgment in favor of the defendants. The three appeals were consolidated by the appellate court. On August 25, 2005, the defendants moved to transfer the appeals to the United States Court of Appeals for the Federal Circuit on the ground that patent issues are involved in the appeal. On November 7, 2007, the motions panel of the U.S. Court of Appeals for the Second Circuit granted the motion in part, and ordered the appeal by the indirect purchaser plaintiffs transferred to the United States Court of Appeals for the Federal Circuit. On October 15, 2008, the United States Court of Appeals for the Federal Circuit affirmed the dismissal of the indirect purchasers claims, and on December 22, 2008, denied the indirect purchaser plaintiffs petition for rehearing and rehearing en banc. The appeal in the United States Court of Appeals for the Second Circuit by the direct purchaser plaintiffs and plaintiffs CVS and Riteaid remains pending. Other actions are pending in various state courts, including New York, California, Kansas, Tennessee, and Florida . The actions generally allege that the defendants engaged in unlawful, anticompetitive conduct in connection with alleged agreements, entered into prior to Watson s acquisition of Rugby from Sanofi Aventis (Aventis), related to the development, manufacture and sale of the drug substance ciprofloxacin hydrochloride, the generic version of Bayer s brand drug, Cipro®. The actions generally seek declaratory judgment, damages, injunctive relief, restitution and other relief on behalf of certain purported classes of individuals and other

entities. The court hearing the case in New York has dismissed the action. Appellants have sought leave to appeal the dismissal of the New York action to the New York Court of Appeals. On April 18, 2006, the New York Supreme Court, Appellate Division, denied the appellants motion. In the action pending in Kansas, the court has stayed the matter pending the outcome of the appeal in the consolidated case. In the action pending in the California Superior Court for the County of San Diego (*In re: Cipro Cases I & II, JCCP Proceeding Nos. 4154 & 4220*),

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

on July 21, 2004, the California Court of Appeal granted in part and denied in part the defendants petition for a writ of mandate seeking to reverse the trial court s order granting the plaintiffs motion for class certification. Pursuant to the appellate court s ruling, the majority of the plaintiffs will be permitted to pursue their claims as a class. The parties intend to file motions for summary judgment, which are scheduled to be argued to the Superior Court during the third quarter of 2009. The trial is scheduled for January 24, 2010. In addition to the pending actions, Watson understands that various state and federal agencies are investigating the allegations made in these actions. Aventis has agreed to defend and indemnify Watson and its affiliates in connection with the claims and investigations arising from the conduct and agreements allegedly undertaken by Rugby and its affiliates prior to Watson s acquisition of Rugby, and is currently controlling the defense of these actions.

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

Beginning in July 2002, the Company and certain of its subsidiaries, as well as numerous other pharmaceutical companies, were named as defendants in various state and federal court actions alleging improper or fraudulent reporting practices related to the reporting of average wholesale prices and wholesale acquisition costs of certain products, and that the defendants committed other improper acts in order to increase prices and market shares. Some of these actions have been consolidated in the U.S. District Court for the District of Massachusetts (*In re: Pharmaceutical Industry Average Wholesale Price Litigation, MDL Docket No. 1456*). The consolidated amended Class Action complaint in that case alleges that the defendants acts improperly inflated the reimbursement amounts paid by various public and private plans and programs. The amended complaint alleges claims on behalf of a purported class of plaintiffs that paid any portion of the price of certain drugs, which price was calculated based on its average wholesale price, or contracted with a pharmacy benefit manager to provide others with such drugs. The Company filed an Answer to the Amended Consolidated Class Action Complaint on April 9, 2004. Defendants in the consolidated litigation have been divided into two groups. Certain defendants, referred to as the Track One defendants, have proceeded on an expedited basis. Classes were certified against these defendants, a trial has been completed with respect to some of the claims against this group of defendants, the presiding judge has issued a ruling granting judgment to the plaintiffs, that judgment is being appealed, and many of the claims have been settled. Other defendants, referred to as the Track Two Defendants , including the Company, have entered into a settlement

agreement resolving all claims against the Track Two Defendants in the Consolidated Class Action. The total amount of the settlement for all of the Track Two Defendants is $125 million. On July 2, 2008, the United States District Court for the District of Massachusetts preliminarily approved the Track Two settlement. The amount to be

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

paid by each Track Two Defendant is confidential. A final hearing on the fairness of the settlement agreement is scheduled for April 27, 2009. The settlement is not expected to materially adversely affect the Company s business, results of operations, financial condition and cash flows.

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

These cases generally allege that the defendants caused the states to overpay pharmacies and other providers for prescription drugs under state Medicaid Programs by inflating the reported average wholesale price or wholesale acquisition cost, and by reporting false prices to the United States government under the Best Prices rebate program. Several of these cases also allege that state residents were required to make inflated copayments for drug purchases under the federal Medicare program, and companies were required to make inflated payments on prescription drug purchases for their employees. Many of these cases, some of which have been removed to federal court, are in the early stages of pleading or are proceeding through pretrial discovery. On January 20, 2006, the Company was dismissed without prejudice from the actions brought by the States of Montana and Nevada because the Company was

not timely served. In the case brought on behalf of the Commonwealth of Massachusetts the Court recently denied cross-motions for summary judgment. The case brought against the Company on behalf of Alabama has been set for trial

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

scheduled to begin in June of 2009; the case brought against the Company on behalf of Kentucky has been scheduled for trial in 2010.

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

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

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

Pursuant to the agreement, Watson hired an independent expert to conduct inspections of the Corona facility at least once each year. In February 2003, February 2004, January 2005, January 2006, January 2007, January-February 2008, and January 2009, respectively, the first, second, third, fourth, fifth, sixth and seventh annual inspections were completed and the independent expert submitted its report of the inspection to the FDA. In each instance, the independent expert reported its opinion that, based on the findings of the audit of the facility, the FDA s applicable cGMP requirements, applicable FDA regulatory guidance, and the collective knowledge, education, qualifications and experience of the expert s auditors and reviewers, the systems at Watson s Corona facility audited and evaluated by the expert are in compliance with the FDA s cGMP regulations. However, the FDA is not required to accept or agree with the independent expert s opinion. The FDA conducted an inspection of that facility from March 31, 2004 until May 6, 2004. At the conclusion of the inspection, the FDA issued a Form 483 listing the observations made during the inspection, including observations related to certain laboratory test methods and other procedures in place at the

facility. In June 2004 the Company submitted its response to the FDA Form 483 inspectional observations and met with FDA officials to discuss its response, including the corrective actions the Company had taken, and intended to take, to address the inspectional observations. The FDA conducted another inspection of the facility from April 5, 2005 through April 13, 2005. At the conclusion of the inspection no formal observations were made and no

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FDA Form 483 was issued. The FDA conducted another inspection of the facility from July 9, 2006 through July 21, 2006. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. From February 20, 2007 through March 9, 2007, the FDA conducted another inspection of the facility. At the conclusion of the inspection, the FDA issued a Form 483 listing the observations made during the inspection. In April 2007 the Company submitted its response to the FDA Form 483 inspectional observations, including the corrective actions the Company has taken to address the inspectional observations. The FDA conducted another inspection of the facility from October 18, 2007 through October 26, 2007. At the conclusion of the inspection, the FDA issued a Form 483 listing two observations made during the pre-approval portion of the inspection related to two pending Abbreviated New Drug Applications (ANDAs). No formal observations were made concerning the Company s compliance with cGMP. The FDA conducted another inspection of the facility from June 16, 2008 through June 27, 2008. At the conclusion of the inspection no formal observations were made and no FDA Form 483 was issued. However, if in the future, the FDA determines that, with respect to its Corona facility, Watson has failed to comply with the consent decree or FDA regulations, including cGMPs, or has failed to adequately address the observations in the Form 483, the consent decree allows the FDA to order Watson to take a variety of actions to remedy the deficiencies. These actions could include ceasing manufacturing and related operations at the Corona facility, and recalling affected products. Such actions, if taken by the FDA, could have a material adverse effect on the Company, its results of operations, financial position and/or cash flows.

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

In January 2005, Elan filed a separate complaint in the U.S. District Court for the Southern District of Florida seeking damages as a result of Andrx s sale of its generic version of Naprelan® (*Elan Corporation PLC v. Andrx Pharmaceuticals, Inc., Case No. 058-60158*). Elan has requested that any damages award be enhanced and that it be awarded attorneys fees based on an allegation of willful infringement by Andrx. In February 2005, Andrx filed its answer to Elan s January 2005 complaint. The trial of this matter has been scheduled to commence April 27, 2009. Discovery is ongoing. The Company sold its 500mg strength naproxen sodium product from September 2002 until

August 13, 2008.

The Company is unable to estimate the ultimate amount of liability or financial impact, if any, of these matters as of the filing of this Annual Report. The Court has scheduled trial in April to May 2009 to consider

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Elan s request for damages and other relief. A final adverse determination of either of these matters could have a material adverse effect on the Company s business, results of operations, financial condition 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 other commercial arrangements between the Company and third parties. These investigations relate to the Company s August 2006 settlement with Cephalon, Inc. related to the Company s generic version of Provigil® (modafinil), and its April 2007 agreement with Sandoz, Inc. related to the Company s forfeiture of its entitlement to 180 days of marketing exclusivity for its 50 milligram dosage strength of its generic version of Toprol XL® (metoprolol xl). The Company believes these agreements comply with applicable laws and rules. However, if the Federal Trade Commission concludes that any of these agreements violate applicable antitrust laws or rules, it could initiate legal action against the Company. These actions, if successful, could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

Androgel® Antitrust Litigation. On January 29, 2009, the U.S. Federal Trade Commission and the State of California filed a lawsuit in the United States District Court for the Central District of California (*Federal Trade Commission, et. al. v. Watson Pharmaceuticals, Inc., et. al., USDC Case No. CV 09-00598)* alleging that the Company s September 2006 patent lawsuit settlement with Solvay Pharmaceuticals, Inc., related to AndroGel® 1% (testosterone gel) CIII is unlawful. The complaint generally alleges that the Company improperly delayed its launch of a generic version of Androgel in exchange for Solvay s agreement to permit the Company to co-promote Androgel for consideration in excess of the fair value of the services provided by the Company. The complaint alleges violation of federal and state antitrust and consumer protection laws and seeks equitable relief and civil penalties. On February 2 and 3, 2009, three separate lawsuits alleging similar claims were filed in the United States District Court for the Central District of California by various private plaintiffs purporting to represent certain classes of similarly situated claimants. (Meijer, Inc., et. al., v. Unimed Pharmaceuticals, Inc., et. al., USDC Case No. EDCV 09-0215) ; (Rochester Drug Co-Operative, Inc. v. Unimed Pharmaceuticals Inc., et. al., Case No. EDCV 09-0226); (Louisiana Wholesale Drug Co. Inc. v. Unimed Pharmaceuticals Inc., et. al, Case No. EDCV 09-0228). All of these lawsuits are at the pleading stages. Additional actions are anticipated. The Company believes that these actions are without merit and intends to defend itself vigorously. However, these actions, if successful, could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

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

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 103 cases are pending against Watson and/or its affiliates in state and federal

courts representing claims by approximately 110 plaintiffs. Many of the cases involve multiple plaintiffs. The majority of the cases have been transferred to and consolidated in the United States District Court for the Eastern District of Arkansas (*In re: Prempro Products Liability Litigation, MDL Docket No. 1507*). Discovery in these cases is ongoing. The Company maintains product liability

Table of Contents

WATSON PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

insurance against such claims. However, these actions, if successful, or if insurance does not provide sufficient coverage against the claims, could adversely affect the Company and could have a material adverse effect on the Company s business, results of operations, financial condition and cash flows.

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

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

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

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.

Table of Contents

Schedule II
Watson Pharmaceuticals, Inc.

Valuation and Qualifying Accounts
Years Ended December 31, 2008, 2007 and 2006

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions/ Write-offs	Other*	Balance at End of Period
			(In thousands)		
Allowance for doubtful accounts:					
Year ended December 31, 2008	$ 3,794	$ 1,173	$ (1,672)		$ 3,295
Year ended December 31, 2007	5,914	87	(2,207)		3,794
Year ended December 31, 2006	950	659	(665)	4,970	5,914
Inventory reserves:					
Year ended December 31, 2008	47,725	45,693	(58,712)		34,706
Year ended December 31, 2007	58,268	46,853	(57,396)		47,725
Year ended December 31, 2006	28,905	29,777	(36,226)	35,812	58,268
Tax valuation allowance:					
Year ended December 31, 2008	12,493	(605)	(3,761)		8,127
Year ended December 31, 2007	11,949	544			12,493
Year ended December 31, 2006	5,265	6,684			11,949

* Represents opening balances of businesses acquired in the period.

Table of Contents

SUPPLEMENTARY DATA (UNAUDITED)

Selected unaudited quarterly consolidated financial data and market price information are shown below:

	For Three Month Periods Ended			
	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008	Mar. 31, 2008
Net revenues	$ 645,225	$ 640,691	$ 622,636	$ 626,949
Cost of sales	376,167	386,655	359,898	380,102
Gross profit	269,058	254,036	262,738	246,847
Operating expenses	178,929	167,094	163,701	164,827
Provision for income taxes	30,229	22,975	35,568	31,162
Net income	$ 56,386	$ 71,061	$ 60,303	$ 50,629
Basic earnings per share	$ 0.55	$ 0.69	$ 0.59	$ 0.49
Diluted earnings per share	$ 0.50	$ 0.62	$ 0.53	$ 0.45
Market price per share:				
High	$ 29.65	$ 31.38	$ 32.70	$ 29.56
Low	$ 20.17	$ 26.66	$ 25.03	$ 23.90

	For Three Month Periods Ended			
	Dec. 31, 2007	Sept. 30, 2007	June 30, 2007	Mar. 31, 2007
Net revenues	$ 627,335	$ 594,706	$ 603,005	$ 671,605
Cost of sales	373,178	346,420	360,438	424,720
Gross profit	254,157	248,286	242,567	246,885
Operating expenses	188,267	186,189	176,820	184,959
Provision for income taxes	21,415	20,779	21,019	20,041
Net income	$ 38,403	$ 34,606	$ 36,409	$ 31,612
Basic earnings per share	$ 0.37	$ 0.34	$ 0.36	$ 0.31
Diluted earnings per share	$ 0.34	$ 0.31	$ 0.33	$ 0.29
Market price per share:				
High	$ 32.53	$ 33.91	$ 33.28	$ 29.43

Low	$ 26.90	$ 28.77	$ 26.16	$ 25.02

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
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	The Company s By-laws, as amended and restated as of July 27, 2001, are incorporated by reference to Exhibit 3.2 to the Company s June 30, 2001 Form 10-Q.
4.1	Indenture dated March 7, 2003 between the Company and Wells Fargo Bank, National Association as Trustee for the issuance of the Company s 1.75% Convertible Senior Debentures, is incorporated by reference to Exhibit 4.2 to the Company s March 31, 2003 Form 10-Q.
*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.
*10.3	Form of Key Employee Agreement. The Company has entered into a Key Employee Agreement in substantially the form filed and incorporated by reference to Exhibit 10.4 to the Company s 2000 Form 10-K with certain of its executive officers, who include Edward F. Heimers, David A. Buchen, Gordon Munro and R. Todd Joyce. A copy of each of these individual s Key Employee Agreements will be provided to the Staff upon request.
*10.4	Key Employment Agreement entered into as of August 15, 2002 by and between Charles Ebert and the Company, is incorporated by reference to Exhibit 10.1 to the Company s September 30, 2002 Form 10-Q.
*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.
*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.
*10.7	Key Employment Agreement entered into as of December 11, 2006 by and between Thomas Giordano and the Company is incorporated by reference to Exhibit 10.6 to the Company s 2006 Form 10-K.
*10.8	Form of Amendment to Key Employee Agreement. On or about December 31, 2008, the Company entered into an Amendment to Key Employee Agreement in substantially the form attached hereto with certain of its Executive Officers, including Edward F. Heimers, Mark W. Durand, Al Paonessa III, Thomas Giordano and Gordon Munro. A copy of each of these individual s Amendment to Key Employee Agreements will be provided to the Staff upon request.
*10.9	Form of Amendment to Key Employee Agreement. On or about December 31, 2008, the Company entered into an Amendment to Key Employee Agreement in substantially the form attached hereto with certain of its Executive Officers, including David A. Buchen and Charles Ebert. A copy of each of these individual s Amendment to Key Employee Agreements will be provided to the Staff upon request.
+10.10	Distribution Agreement between R&D Laboratories, Inc. and Rhone-Poulenc Rorer GmbH dated June 24, 1993, as amended June 28, 1994, is incorporated by reference to Exhibit 10.12 to the Company s 2000 Form 10-K (the first agreement together know as the Ferrlecit Agreements).

+10.11 Manufacturing & Supply Agreement between R&D Laboratories, Inc. and Rhone-Poulenc Rorer GmbH dated December 1, 1998, as amended by that Amendment No. 1 dated in 2000, is incorporated by reference to Exhibit 10.13 to the Company s 2000 Form 10-K (the third agreement together know as the Ferrlecit Agreements).

Table of Contents

Exhibit No.	Description
+10.12	Trademark Agreement between R&D Laboratories, Inc. and Rhone-Poulenc Rorer GmbH dated August 26, 1993, as amended by that Amendment No. 1 dated in 2000, is incorporated by reference to Exhibit 10.14 to the Company s 2000 Form 10-K (the second agreement together know as the Ferrlecit Agreements). Amendment to the Arbitration Provisions of the Ferrlecit Agreements (defined as the Distribution Agreement, Manufacturing & Supply Agreement and Trademark Agreement between R&D Laboratories, Inc. and Rhone-Poulenc Rorer GmbH listed as Exhibits 10.10, 10.11 and 10.12, respectively) dated August 25, 2008, between R&D Ferrlecit Capital Resources, Inc., A. Nattermann & CIE. GmbH and May & Baker Limited, trading as sanofi-aventis is incorporated by reference to Exhibit 10.2 to the Company s September 30, 2008 Form 10-Q.
10.13	Resale Registration Rights Agreement dated as of March 7, 2003 among the Company and Lehman Brothers Inc., Morgan Stanley & Co., Incorporated, CIBC World Markets Corp., Wachovia Securities, Inc., Banc of America Securities LLC, Comerica Securities, Inc. and Wells Fargo Securities, LLC., is incorporated by reference to Exhibit 10.16 to the Company s March 31, 2003 Form 10-Q.
10.14	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.
*10.15	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.
*10.16	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.
*10.17	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.
*10.18	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.
*10.19	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.
*10.20	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.
*10.21	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.
*10.22	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.
+10.23	Distribution Agreement between Amphastar Pharmaceuticals, Inc. and Andrx Pharmaceuticals, Inc. dated as of May 2, 2005, is incorporated by reference to Exhibit 10.102 of Andrx Corporation s 2005 Form 10-K.
+	First Amendment to Distribution Agreement between Amphastar Pharmaceuticals, Inc. and Andrx Pharmaceuticals, Inc. d/b/a Watson Laboratories Florida dated August 15, 2008 is incorporated

	by reference to Exhibit 10.1 to the Company s September 30, 2008 Form 10-Q.
+10.24	Agreement to License and Purchase by and among Andrx Labs, LLC, Andrx Laboratories, Inc., Andrx Laboratories (NJ), Inc., Andrx EU Ltd. and First Horizon Pharmaceutical Corporation dated as of March 2, 2005, is incorporated by reference to Exhibit 10.100 to Andrx Corporation s March 31, 2005 Form 10-Q.

Table of Contents

Exhibit No.	Description
+10.25	Manufacturing and Supply Agreement between Andrx Pharmaceuticals, Inc. and First Horizon Pharmaceutical Corporation dated as of March 28, 2005, is incorporated by reference to Exhibit 10.101 to Andrx Corporation s March 31, 2005 Form 10-Q.
*10.26	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.
*10.27	Amendment to Watson Pharmaceuticals, Inc. Key Employee Agreement entered into as of December 22, 2008 by and between Paul M. Bisaro and the Company.
*10.28	Key Employee Agreement between Watson Pharmaceuticals, Inc. and Mark W. Durand, dated as of November 26, 2007, is incorporated by reference to Exhibit 10.1 to the Company s November 16, 2007 Form 8-K.
*10.29	Key Employee Agreement between Anda, Inc. and Al Paonessa III, dated as of August 2, 2007 is incorporated by reference to Exhibit 10.28 to the Company s 2007 Form 10-K.
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.

* Compensation Plan or Agreement

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