ENDO PHARMACEUTICALS HOLDINGS INC
Form 10-Q
August 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007.

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: 001-15989

ENDO PHARMACEUTICALS HOLDINGS INC.

(Exact Name of Registrant as Specified in Its Charter)

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

100 Endo Boulevard

Chadds Ford, Pennsylvania 19317

(Address of Principal Executive Offices)

(610) 558-9800

(Registrant s Telephone Number, Including Area Code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practical date.

Common Stock, $0.01 par value — Shares outstanding as of August 3, 2007: 134,033,440

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ENDO PHARMACEUTICALS HOLDINGS INC.

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FORWARD LOOKING STATEMENTS

This document contains information that includes or is based on forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements, including estimates of future net sales, future expenses, future net income and future earnings per share, contained in the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations, are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed results of operations. Also, statements including words such as believes, expects, anticipates, intends, estimates, plan, will, may or similar expressions are forward-looking statements. We these forward-looking statements on our current expectations and projections about the growth of our business, our financial performance and the development of our industry. Because these statements reflect our current views concerning future events, these forward-looking statements involve risks and uncertainties. Investors should note that many factors, as more fully described or incorporated by reference in Item 1A Risk Factors in this document, supplement, and as otherwise enumerated herein, could affect our future financial results and could cause our actual results to differ materially from those expressed in forward-looking statements contained in this document. Important factors that could cause our actual results to differ materially from the expectations reflected in the forward-looking statements in this document include those factors described in this document under Item 1A titled Risk Factors, including, among others:

our ability to successfully develop, commercialize and market new products;

timing and results of pre-clinical or clinical trials on new products;

our ability to obtain regulatory approval of any of our pipeline products;

competition for the business of our branded and generic products, and in connection with our acquisition of rights to intellectual property assets;

significant cash payments we may be required to make to Endo Pharma LLC pursuant to a tax sharing agreement;

market acceptance of our future products;

government regulation of the pharmaceutical industry;

our dependence on a small number of products;

our dependence on outside manufacturers for the manufacture of our products;

our dependence on third parties to supply raw materials and to provide services for certain core aspects of our business;

new regulatory action or lawsuits relating to our use of narcotics in most of our core products;

our exposure to product liability claims and product recalls and the possibility that we may not be able to adequately insure ourselves;

our ability to protect our proprietary technology;

the successful efforts of manufacturers of branded pharmaceuticals to use litigation and legislative and regulatory efforts to limit the use of generics and certain other products;

our ability to successfully implement our acquisition and in-licensing strategy;

regulatory or other limits on the availability of controlled substances that constitute the active ingredients of some of our products and products in development;

the availability of third-party reimbursement for our products;

the outcome of any pending or future litigation or claims by the government;

our dependence on sales to a limited number of large pharmacy chains and wholesale drug distributors for a large portion of our total net sales;

significant litigation expenses to defend or assert patent infringement claims;

any interruption or failure by our suppliers, distributors and collaboration partners to meet their obligations pursuant to various agreements with us;

a determination by a regulatory agency that we are engaging in inappropriate sales or marketing activities, including promoting the off-label use of our products;

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existing suppliers become unavailable or lose their regulatory status as an approved source, causing an inability to obtain required components, raw materials or products on a timely basis or at commercially reasonable prices; and

the loss of branded product exclusivity periods and related intellectual property.

We do not undertake any obligation to update our forward-looking statements after the date of this Report for any reason, even if new information becomes available or other events occur in the future. You are advised, however, to consult any further disclosures we make on related subjects in our 10-Q, 10-K and 8-K reports to the Securities and Exchange Commission (or SEC). Also note that we provide the preceding cautionary discussion of risks, uncertainties and possibly inaccurate assumptions relevant to our business. These are factors that, individually or in the aggregate, we think could cause our actual results to differ materially from expected and historical results. We note these factors for investors as permitted by the Private Securities Litigation Reform Act of 1995. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider the preceding to be a complete discussion of all potential risks or uncertainties.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ENDO PHARMACEUTICALS HOLDINGS INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share data)

	June 30, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 445,829	$ 628,085
Marketable securities	360,925	
Accounts receivable, net	222,118	279,159
Inventories	72,904	62,129
Prepaid expenses and other current assets	11,028	11,663
Deferred income taxes	54,552	54,978
Total current assets	1,167,356	1,036,014
PROPERTY AND EQUIPMENT, Net	43,304	36,565
GOODWILL	181,079	181,079
OTHER INTANGIBLES, Net	74,942	78,046
NOTE RECEIVABLE	50,158	52,872
DEFERRED INCOME TAXES		1,745
OTHER ASSETS	10,758	10,368
TOTAL ASSETS	$ 1,527,597	$ 1,396,689
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 126,109	$ 122,647
Accrued expenses	163,852	164,528
Due to Endo Pharma LLC	19,301	38,693
Estimated amount due seller, current portion	15,000	
Income taxes payable	16,875	12,231
Total current liabilities	341,137	338,099
DEFERRED INCOME TAXES	4,746	
ESTIMATED AMOUNT DUE SELLER	530	15,530
OTHER LIABILITIES	11,084	2,072
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
STOCKHOLDERS EQUITY:		
Preferred Stock, $0.01 par value; 40,000,000 shares authorized; none issued		
Common Stock, $0.01 par value; 175,000,000 shares authorized; 133,971,183 and 133,600,959 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	1,340	1,336
Additional paid-in capital	694,327	679,704
Retained earnings	473,874	358,831

Accumulated other comprehensive income	559	1,117
Total stockholders equity	1,170,100	1,040,988
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,527,597	$ 1,396,689

See Notes to Condensed Consolidated Financial Statements.

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ENDO PHARMACEUTICALS HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
NET SALES	$ 257,147	$ 228,020	$ 511,556	$ 433,063
COST OF SALES (1)	53,460	50,408	101,855	99,145
GROSS PROFIT	203,687	177,612	409,701	333,918
COSTS AND EXPENSES:				
Selling, general and administrative	87,024	64,264	179,806	164,431
Research and development	26,276	19,772	52,685	44,926
Depreciation and amortization	4,015	4,346	7,928	8,308
OPERATING INCOME	86,372	89,230	169,282	116,253
INTEREST INCOME, Net	8,264	5,658	15,282	10,221
INCOME BEFORE INCOME TAX	94,636	94,888	184,564	126,474
INCOME TAX	34,090	37,252	66,869	48,300
NET INCOME	$ 60,546	$ 57,636	$ 117,695	$ 78,174
NET INCOME PER SHARE:				
Basic	$ 0.45	$ 0.43	$ 0.88	$ 0.59
Diluted	$ 0.45	$ 0.43	$ 0.88	$ 0.58
WEIGHTED AVERAGE SHARES:				
Basic	133,820	133,051	133,725	132,964
Diluted	134,504	133,936	134,395	133,864
(1) Excludes the following amounts of amortization expense related to commercial products:	$ 1,230	$ 1,945	$ 2,460	$ 3,523

See notes to Condensed Consolidated Financial Statements.

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ENDO PHARMACEUTICALS HOLDINGS INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

	Six Months Ended June 30,	
	2007	**2006**
OPERATING ACTIVITIES:		
Net income	$ 117,695	$ 78,174
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,928	8,308
Stock-based compensation	7,233	5,536
Interest earned on available-for-sale securities	(313)	
Accretion of interest on note receivable	(620)	(620)
Deferred income taxes	8,660	8,856
Tax benefits of stock options exercised		
Amortization of deferred financing costs		191
(Gain) loss on disposal of property and equipment	(151)	902
Selling, general and administrative expenses to be funded by Endo Pharma LLC		41,330
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable	57,041	31,170
Inventories	(10,775)	(10,815)
Note receivable	(493)	(1,337)
Prepaid and other assets	4,871	6,576
Accounts payable	(628)	14,945
Accrued expenses	390	(35,716)
Due to Endo Pharma LLC		(24,900)
Other liabilities	1,918	
Income taxes receivable/payable	8,347	78,508
Net cash provided by operating activities	201,103	201,108
INVESTING ACTIVITIES:		
Purchase of property and equipment	(8,885)	(5,196)
Proceeds from the sale of property and equipment	268	67
Purchases of available-for-sale securities	(360,612)	
Acquisitions of license rights		(19,000)
Distribution from equity method investee	1,096	
Other investments	(2,800)	
Net cash used in investing activities	(370,933)	(24,129)
FINANCING ACTIVITIES:		
Capital lease obligations repayments	(498)	(1,294)
Tax sharing payments to Endo Pharma LLC	(20,000)	(96,715)
Tax benefits of stock options exercised	2,813	29,849
Exercise of Endo Pharmaceuticals Holdings Inc. Stock Options	5,259	2,929
Net cash used in financing activities	(12,426)	(65,231)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(182,256)	111,748
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	628,085	500,956

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 445,829	$ 612,704
SUPPLEMENTAL INFORMATION:		
Interest paid	$ 47	$ 388
Income taxes paid	$ 45,431	$ 159
SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Purchase of property and equipment financed by capital leases	$ 73	$ 185
Change in accrual for purchases of property and equipment	$ (4,090)	$ (2,955)

See Notes to Condensed Consolidated Financial Statements.

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ENDO PHARMACEUTICALS HOLDINGS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying condensed consolidated financial statements of Endo Pharmaceuticals Holdings Inc. (the Company or we or Endo) and its subsidiaries, which are unaudited, include all normal and recurring adjustments considered necessary to present fairly the Company s financial position as of June 30, 2007 and the results of our operations and our cash flows for the periods presented. Operating results for the three-month and six-month periods ended June 30, 2007 is not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

The accompanying condensed consolidated balance sheet as of December 31, 2006 is derived from the Company s audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Since certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted, we suggest that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto as of and for the year ended December 31, 2006 contained in the Company s Annual Report on Form 10-K.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes*. FIN 48 creates a single model to address uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 clearly scopes out income taxes from Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*. FIN 48 is effective for fiscal years beginning after December 15, 2006. We have adopted FIN No. 48 as of January 1, 2007. The adoption resulted in a charge of $2.7 million recorded directly to retained earnings as a cumulative-effect of a change in accounting principle. See Note 13 for further discussion.

In September 2006, the FASB issued SFAS No.157 (SFAS 157), *Fair Value Measurements*, which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under accounting principles generally accepted in the United States. SFAS 157 is effective for fiscal years

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beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of this Statement on its financial statements.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159) *The Fair Value Option for Financial Assets and Financial Liabilities*, providing companies with an option to report selected financial assets and liabilities at fair value. This Standard s objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. SFAS 159 helps to mitigate this type of accounting-induced volatility by enabling companies to report related assets and liabilities at fair value, which would likely reduce the need for companies to comply with detailed rules for hedge accounting. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. This Standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the Company s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the Company has chosen to use fair value on the face of the balance sheet. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of the adoption of this Statement on its financial statements.

In June 2007, the Accounting Standards Executive Committee (AcSEC) issued Statement of Position 07-1 *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (SOP 07-1). SOP 07-1 provides guidance for determining whether an entity is within the scope of the *AICPA Audit and Accounting Guide, Investment Companies* (the Guide), and whether investment company accounting should be retained by a parent company upon consolidation of an investment company subsidiary or by an equity method investor in an investment company. For purposes of the separate financial statements of an entity, SOP 07-1 indicates that the Guide is applicable to investment companies that are (1) entities regulated by the Investment Company Act of 1940 or similar requirements, and (2) separate legal entities whose business purpose and activity are investing in multiple substantive investments for current income, capital appreciation, or both, with investment plans that include exit strategies. The Guide is not applicable to entities that hold investments for strategic operating purposes. Entities that previously applied the provisions of the Guide, but no longer meet the provisions of SOP 07-1 to be an investment company within the scope of the Guide, should report the effects of adopting SOP 07-1 prospectively by accounting for their investments in conformity with GAAP other than investment company accounting. The fair value of the investments (determined in conformity with investment company accounting) should be considered the carrying amount of the investments at the date of adoption. Entities that are investment companies within the scope of the Guide, but that previously had not followed the provisions of the Guide, should report the cumulative effect of adopting SOP 07-1 as an adjustment to opening retained earnings as of the beginning of the year that SOP 07-1 is adopted. The provisions of SOP 07-1 are effective for fiscal years beginning on or after December 15, 2007, with earlier application encouraged. The Company is currently evaluating the impact of the adoption of this Statement on its financial statements.

In June 2007, the FASB ratified the consensus reached by the Emerging Issues Task Force (Task Force) in Issue No. 07-3 (EITF 07-3), *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*. Under EITF 07-3, nonrefundable advance payments for goods or services that will be used or rendered for research and development activities should be deferred and capitalized. Such payments should be recognized as an expense as the goods are delivered or the related services are performed, not when the advance payment is made. If a Company does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. EITF 07-3 is effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. Companies are required to report the effects of applying EITF 07-3 prospectively for new contracts entered into on or after the effective date. The Company is currently evaluating the impact of the adoption of EITF 07-3 on its consolidated financial statements.

3. MARKETABLE SECURITIES

The Company accounts for investments in marketable securities in accordance with the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Marketable securities consist of auction rate securities, variable rate demand obligations and publicly traded equity securities.

Auction rate securities and variable rate demand obligations are long-term variable rate bonds tied to short-term interest rates. After the initial issuance of the securities, the interest rate on the securities is reset periodically, at intervals established at the time of issuance (e.g., every seven, twenty-eight, or thirty-five days; every six months; etc.), based on the market demand for a reset period. Auction rate securities are bought and sold in the marketplace through a competitive bidding process, often referred to as a Dutch auction . Variable rate demand obligations are typically bought and sold through a remarketing process, whereby an investor tenders their bonds to a trustee for purchase at any auction or remarketing date. A remarketing agent resets the interest rate on variable rate demand obligations to a rate that will successfully allow remarketing of those bonds and remarkets the bonds to new investors.

We classify our marketable securities as available-for-sale securities. Management determines the appropriate classification of marketable securities at the time of purchase and reevaluates such designation as of each balance sheet date. Available-for-sale securities are carried at fair market value. Our equity securities are included in Other assets. Unrealized gains and losses, net of tax, are included in accumulated other comprehensive income as a separate component of stockholders equity. The Company recognizes an impairment charge when the declines in the fair values of its investments below the cost basis are judged to be other-than-temporary. The Company considers various factors in determining whether to recognize a decline in value, including the length of time and extent to which the fair value has been less than the Company s cost basis, the financial condition and near-term prospects of the issuer or investee, and the Company s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. The Company has not recorded any such impairment in any of the periods presented. The cost of securities sold is based on the specific identification method. The Company classifies investments in marketable securities as current when their remaining time to maturity is less than or equal to 12 months or, if time to maturity is greater than 12 months, when they represent investments of cash that are intended to be used in current operations.

The cost of the debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion, along with realized gains and losses, are included in interest income, net.

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While the underlying securities of auction rate securities and variable rate demand obligations generally have contractual maturities between 20 and 30 years, the interest rates on such securities typically reset at intervals between 7 to 35 days. Despite the underlying long-term maturity of these securities, from the investor s perspective, such securities are priced and subsequently trade as short-term investments because of the interest rate reset feature. As a result, the Company has the ability to quickly liquidate these securities. The Company has no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. All income generated from these short-term investments has been recorded as interest income.

Our investments in marketable securities are governed by our investment policy, which has been approved by our Board of Directors. Our investment policy seeks to preserve the value of capital, consistent with maximizing return on the Company s investment, while maintaining adequate liquidity.

4. INVENTORIES, NET

Inventories are comprised of the following at June 30, 2007 and December 31, 2006, respectively (in thousands):

	June 30, 2007	December 31, 2006
Raw Materials	$ 10,781	$ 7,619
Work-in-Process	17,963	9,718
Finished Goods	44,160	44,792
Total	$ 72,904	$ 62,129

5. LICENSE AND COLLABORATION AGREEMENTS

DURECT Corporation

In April 2007, DURECT and Endo entered into Amendment No. 4 to the Development, Commercialization and Supply License Agreement dated November 8, 2002 (the DURECT CHRONOGESIC™ License Agreement) relating to the development and commercialization of the CHRONOGESIC™ product candidate in the U.S. and Canada. Prior to the present amendment, in addition to other specified termination rights provided to both parties, the DURECT CHRONOGESIC™ License Agreement provided Endo with a right to terminate the DURECT CHRONOGESIC™ License Agreement starting March 31, 2007 in the event that DURECT had not commenced a specified clinical trial for the CHRONOGESIC™ product candidate on or before March 31, 2007, *provided that* Endo provided DURECT written notice of such termination prior to April 30, 2007. Under Amendment No. 4, the foregoing termination right was amended to provide Endo with the right to terminate the DURECT CHRONOGESIC™ License Agreement in the event that (i) DURECT had not delivered to Endo on or before March 31, 2008 a written notice that a human pharmacokinetic trial had been completed with the CHRONOGESIC™ product candidate, together with a full study report of the results of the trial or (ii) Endo, determines, in its sole discretion, to terminate the DURECT CHRONOGESIC™ License Agreement during the sixty-day period after DURECT s delivery of such notice, *provided that*, in each case Endo delivers to DURECT its written notice of termination prior to April 30, 2008. Under Amendment No. 4, Endo shall not be responsible for any development costs for the CHRONOGESIC™ product candidate prior to May 1, 2008. Commencing on May 1, 2008, unless the DURECT CHRONOGESIC™ License Agreement is earlier terminated by Endo, Endo will fund 50% of the ongoing development costs for the CHRONOGESIC™ product candidate in accordance with the terms of the DURECT CHRONOGESIC™ License Agreement. Endo will also reimburse DURECT for a portion of its prior development costs upon the achievement of certain milestones. Milestone payments made by Endo under the DURECT CHRONOGESIC License Agreement could total up to $52.0 million. Endo and DURECT will share profits equally, based on projected financial performance of CHRONOGESIC . In addition, the DURECT CHRONOGESIC License Agreement also contains terms and conditions customary for this type of arrangement, including representations, warranties, indemnities and termination rights. The DURECT CHRONOGESIC License Agreement generally lasts until the underlying patents on the product expire. With respect to termination rights, the DURECT CHRONOGESIC License Agreement permits Endo to terminate its continued participation under a number of circumstances, one of which could require Endo to pay DURECT up to $10.0 million.

SkyePharma, Inc.

In January 2007, following an assessment of the status of DepoDur®, we announced that we notified SkyePharma PLC of our intent to terminate our development and commercialization agreement for this product and, in February 2007, entered into a termination agreement with SkyePharma whereby the Development and Marketing Strategic Alliance Agreement terminated in its entirety on March 31, 2007. In order to provide for the continued commercial support of the DepoDur® product and the transition of such product to SkyePharma on March 31, 2007, Endo continued to provide a number of services and undertake certain activities. Specifically, Endo employed commercially reasonable efforts to maintain and continue all U.S. commercial activities in support of DepoDur® through March 31, 2007, and support and/or undertake the

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transition of certain Endo functions and activities (including third party activities) to SkyePharma that were useful and necessary for SkyePharma to assume commercial and related responsibilities for DepoDur® in the U.S.

Orexo AB

Our agreement with Orexo provides for us to make additional license fees and payments based on development and regulatory milestones, which may total up to $22.1 million through FDA approval of Rapinyl s New Drug Application, $17.7 million of which has been recorded through June 30, 2007 and included in research and development expense. Of this $17.7 million expensed from the inception of the agreement through June 30, 2007, $5.2 million has been recorded during each of the six months ended June 30, 2007 and 2006.

Vernalis Development Limited

In July 2007, Vernalis and Endo entered into Amendment No. 3 (Amendment) to the License Agreement dated July 14, 2004. Under the Amendment, Vernalis granted to Endo, a sole and exclusive (even as against Vernalis) license to make, have made, use, commercialize and have commercialized the product Frova® (frovatriptan) in Canada, under the Canadian Trademark.

Novopharm Limited

In July 2007, Novopharm Limited (Novopharm) and Endo entered into a License Agreement (the Novopharm Agreement) whereby Endo granted to Novopharm the exclusive right to use, import, sell, have sold, offer to sell, distribute, market, promote and otherwise exploit the product Frova® (frovatriptan) in Canada. Novopharm will pay to the Company an upfront license fee of approximately $0.2 million and has agreed to make additional milestone payments totaling $0.7 million upon the occurrence of certain events or based on the passage of time. In addition to the milestone payments, Novopharm will pay to Endo royalties based on a certain percentage of net sales as defined in the Novopharm Agreement. The term of the Novopharm Agreement will continue until the later to occur of 10 years after its July 2007 effective date or the expiration of the last Frova® patent in Canada. We have the right after December 31, 2010 to terminate the Novopharm Agreement upon one hundred eighty (180) days prior written notice to Novopharm, and may be required to make annual royalty payments to Novopharm for a period of up to three years after such termination on any sales in Canada made by Endo or any of its affiliates during that three-year period.

6. GOODWILL AND OTHER INTANGIBLES

Our goodwill and other intangible assets consist of the following at June 30, 2007 and December 31, 2006, respectively (in thousands):

	June 30, 2007	December 31, 2006
Goodwill	$ 181,079	$ 181,079
Amortizable Intangibles:		
Licenses	$ 94,621	$ 94,621
Patents	3,200	3,200
	97,821	97,821
Less accumulated amortization	(22,879)	(19,775)
Other intangibles, net	$ 74,942	$ 78,046

Estimated amortization of intangibles for the five fiscal years subsequent to December 31, 2006 is as follows (in thousands):

2007	$ 6,209
2008	6,209

2009	6,209
2010	6,209
2011	6,209

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7. NOTE RECEIVABLE

In July 2004, we entered into a license agreement and a loan agreement with Vernalis Development Limited, or Vernalis, under which Vernalis agreed to exclusively license to us the rights to market Frova® (frovatriptan) in North America. Under the loan agreement, we provided Vernalis with a loan of $50 million in August 2004. The loan was primarily used to make a payment in full and final settlement of the amounts due to Elan Corporation from Vernalis in connection with Vernalis reacquisition of the North American rights to Frova®. The loan is secured against the revenues receivable by Vernalis under the license agreement. At our election, we are able to offset $20 million of the $40 million menstrual migraine indication approval milestone and 50% of all royalties to be paid under the license agreement to Vernalis to repay the loan *provided that*, in each case Endo delivers to Vernalis written notice not less than five (5) business days prior to the due date of any payment. During the three and six months ended June 30, 2007, we expensed royalties payable to Vernalis in the amount of approximately $1.9 million and $3.7 million, respectively. We have notified Vernalis that 50% of these royalties will not be paid to Vernalis, but will be used to offset a portion of the unpaid accrued interest on the note receivable. To the extent not previously repaid, the loan is due in full after five years. Interest is at the rate of 5% per annum payable semi-annually. However, Vernalis has the option to defer payment of interest and increase the loan outstanding each time an interest payment becomes due. Vernalis has elected to defer the payment of the first six semi-annual interest amounts otherwise due January 31 and July 31 totaling approximately $7.8 million. We have and expect to continue to offset 50% of future royalty payment obligations to Vernalis against these interest payment deferrals and consequently we have reclassified a portion of the accrued interest on the note receivable to other current assets.

We estimated that an approximate fair market rate of interest for this type of secured loan was 8% per annum and therefore recorded the note receivable at its present value at inception of $43.8 million. The note receivable is being accreted up to its face amount at maturity using the effective interest method and thus the effective interest rate over the five-year term will be 8% per annum. The difference of $6.2 million between the face amount of the note and its present value at inception has been treated as additional consideration paid to acquire the license rights and has been included in other intangibles, net.

8. COMPREHENSIVE INCOME

Comprehensive income includes the following components for the three and six months ended June 30, 2007 and 2006 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	$ 60,546	$ 57,636	$ 117,695	$ 78,174
Other comprehensive income:				
Unrealized losses on securities, net of tax	(293)	(2,358)	(558)	(1,136)
Total comprehensive income	$ 60,253	$ 55,278	$ 117,137	$ 77,038

9. COMPENSATION RELATED TO STOCK OPTIONS

Endo Pharma LLC 1997 Executive and Employee Stock Option Plans and Endo Pharma LLC 2000 Supplemental Executive and Employee Stock Option Plans

On November 25, 1997, the Company established the 1997 Employee Stock Option Plan and the 1997 Executive Stock Option Plan (collectively, the 1997 Stock Option Plans). On July 17, 2000, the 1997 Stock Option Plans were amended and restated. The Endo Pharma LLC 1997 Stock Option Plans are these amended and restated 1997 Stock Options Plans and reserved an aggregate of 25,615,339 shares of common stock of the Company held by Endo Pharma LLC for issuance. Stock options granted under the Endo Pharma LLC 1997 Stock Option Plans expire on August 26, 2007. Upon exercise of these stock options, only currently outstanding shares of common stock of the Company held by Endo Pharma LLC are issued. Endo Pharma LLC is a limited liability company that is no longer affiliated with the Company and in which affiliates of Kelso & Company have a controlling interest. Exercise of these stock options has not and will not result in the issuance of additional shares in the Company and does not dilute the ownership interests of our public stockholders.

Pursuant to the Company s merger with Algos Pharmaceutical Corporation (Algos) and related recapitalization of the Company on July 17, 2000, the Endo Pharma LLC 2000 Supplemental Stock Option Plans were established. The Endo Pharma LLC 2000 Supplemental Stock Option Plans

reserved an aggregate of 10,672,314 shares of common stock of the Company held by Endo Pharma LLC for issuance. Stock options granted under the Endo Pharma LLC 2000 Supplemental Stock Option Plans expire on August 26, 2007. The Endo Pharma LLC 2000 Supplemental Stock Option Plans became

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effective on January 1, 2003, resulting in the issuance of 10,672,314 stock options to certain employees and members of management. No additional shares of Company common stock have been or will be issued as a result of the exercise of these stock options, because these stock options are exercisable only into shares of Company common stock that are held by Endo Pharma LLC. Accordingly, exercise of these stock options has not and will not result in the issuance of additional shares in the Company and does not dilute the ownership interests of our public stockholders.

Endo Pharmaceuticals Holdings Inc. 2000, 2004 and 2007 Stock Incentive Plans

On August 11, 2000, we established the Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan. The 2000 Stock Incentive Plan reserves an aggregate of 4,000,000 shares of common stock of the Company for issuance to employees, officers, directors and consultants. The 2000 Stock Incentive Plan provides for the issuance of stock options, restricted stock, stock bonus awards, stock appreciation rights or performance awards. In May 2004, our stockholders approved the Endo Pharmaceuticals Holdings Inc. 2004 Stock Incentive Plan. The maximum number of shares of Company stock reserved for issuance under the 2004 Stock Incentive Plan is 4,000,000 shares. The 2004 Plan provides for the grant of stock options, stock appreciation rights, shares of restricted stock, performance shares, performance units or other share-based awards that may be granted to executive officers and other employees of the Company, including officers and directors who are employees, to non-employee directors and to consultants to the Company. In May 2007, our stockholders approved the Endo Pharmaceuticals Holdings Inc. 2007 Stock Incentive Plan. The maximum number of shares of Company stock reserved for issuance under the 2007 Stock Incentive Plan will be seven million (7,000,000) shares (subject to adjustment for certain transactions), but in no event may the total number of shares of Company stock subject to awards awarded to any one Participant during any tax year of the Company, exceed seven hundred fifty thousand (750,000) shares (subject to adjustment for certain transactions). As of June 30, 2007, both stock options and restricted stock have been awarded under the 2000 and 2004 plans. Stock options granted under the 2000 and 2004 Stock Incentive Plans generally vest over four years and expire ten years from the date of grant. Unlike the stock options granted under the Endo Pharma LLC Stock Option Plans, the exercise of the stock options granted pursuant to the Endo Pharmaceuticals Holdings Inc. 2000 and 2004 Stock Incentive Plans will dilute the ownership interests of our public stockholders. In March 2007, restricted stock was granted to non-employee directors of the Company as part of their annual stock compensation award. This restricted stock will vest ratably over a two-year vesting period (50% on the first anniversary of the grant date and the remaining 50% on the second anniversary of the grant date).

Stock-Based Compensation

The Company accounts for its stock-based compensation plans in accordance with SFAS No. 123(R), *Share-Based Payment* (SFAS 123R). Under SFAS 123R, all stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense in the income statement over the requisite service period.

The Company recognized stock-based compensation expense of $4.2 million and $7.2 million during the three and six months ended June 30, 2007 and $3.2 million and $5.5 million during the three and six months ended June 30, 2006. Presented below is the allocation of stock-based compensation as recorded in our Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006 (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Selling, general and administrative expenses	$ 3,678	$ 2,843	$ 6,374	$ 4,885
Research and development expenses	487	370	859	651
Total stock-based compensation expense	$ 4,165	$ 3,213	$ 7,233	$ 5,536

Stock Options

For all of the Company s stock-based compensation plans, the fair value of each option grant was estimated at the date of grant using the Black-Scholes option-pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield (which is assumed to be zero, as the Company has not paid cash dividends to date and does not currently expect to pay cash dividends) and the expected term of the option. Expected volatilities utilized in the model are based mainly on the historical volatility of the Company s stock price over a period commensurate with the expected life of the share option as well as other factors. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the time of grant. During 2006, in accordance with Staff Accounting Bulletin No. 107 (SAB 107), *Share-Based*

Payment, the Company calculated the expected term of options granted using the simplified method. The simplified method was intended to be a temporary estimation technique and was to be phased out as more detailed information about exercise

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behavior became readily available, but no later than December 31, 2007. Beginning in 2007, we estimate the expected term of options granted based on our historical experience with our employees exercise of stock options and other factors.

A summary of the activity under 2000 and 2004 Stock Incentive Plans for the six months ended June 30, 2007 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, January 1, 2007	3,910,768	$ 21.19		
Granted	1,067,350	$ 30.52		
Exercised	(356,652)	$ 14.74		
Forfeited	(98,376)	$ 26.03		
Expired	(2,336)	$ 18.61		
Outstanding, June 30, 2007	4,520,754	$ 23.80	7.72	$ 47,144,873
Vested and expected to vest, June 30, 2007	4,217,374	$ 23.56	7.66	$ 45,016,338
Exercisable, June 30, 2007	1,528,622	$ 18.00	6.34	$ 24,807,587

The total intrinsic value of options exercised during the six months ended June 30, 2007 and 2006 was $6.4 million and $6.7 million, respectively. The weighted-average grant date fair value of the stock options granted in the six months ended June 30, 2007 and 2006 was $15.19 per option and $15.59 per option, respectively, determined using the following assumptions:

	2007	2006
Average expected term (years)	5.50	6.25
Risk-free interest rate	4.63%	4.59%
Dividend yield	0.00	0.00
Expected volatility	48%	50%

As of June 30, 2007, the total remaining unrecognized compensation cost related to non-vested stock options amounted to $37.3 million. The weighted average remaining requisite service period of the non-vested stock options was 2.5 years. This expected cost does not include the impact of any future stock-based compensation awards.

A summary of the activity under the Endo Pharma LLC 1997 Stock Option Plans and the Endo Pharma LLC 2000 Supplemental Stock Option Plans for the six months ended June 30, 2007 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, vested and exercisable, January 1, 2007	75,259	$ 2.42		
Granted		$		
Exercised	(69,924)	$ 2.42		
Forfeited		$		
Outstanding, vested and exercisable, June 30, 2007	5,335	$ 2.42	0.16	$ 169,706

The total intrinsic value of options exercised during the six months ended June 30, 2007 and 2006 was $2.1 million and $71.4 million, respectively.

As of June 30, 2007, there was no remaining unrecognized compensation cost related to non-vested stock options granted pursuant to the Endo Pharma LLC 1997 Stock Option Plans and the Endo Pharma LLC 2000 Supplemental Stock Option Plans.

Restricted Stock

During the six months ended June 30, 2007, the Company granted restricted stock awards to non-employee directors of the Company as part of their annual stock compensation award. This restricted stock will vest ratably over a two-year vesting period (50% on the first anniversary of the grant date and the remaining 50% on the second anniversary of the grant date).

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We recognize expense for our restricted stock using the straight-line method over the requisite service period. The total value of compensation expense for restricted stock is equal to the closing price of Endo shares on the date of grant.

A summary of our restricted stock as of June 30, 2007, is presented below:

	Number of Shares	Weighted Average Fair Value Per Share	Aggregate Intrinsic Value
Non-vested, January 1, 2007		$	
Granted	13,572	$ 29.84	
Forfeited		$	
Vested		$	$
Nonvested, June 30, 2007	13,572	$ 29.84	

As of June 30, 2007, the total remaining unrecognized compensation cost related to non-vested restricted stock awards amounted to $0.3 million. The weighted average remaining requisite service period of the non-vested restricted stock was 1.7 years. This expected cost does not include the impact of any future stock-based compensation awards.

10. RELATED PARTY TRANSACTIONS

Tax Sharing Agreement. On July 14, 2000, Endo Pharma LLC was formed in connection with our merger with Algos Pharmaceutical Corporation (Algos) to ensure that the stock options granted pursuant to the Endo Pharma LLC Stock Option Plans diluted only the Endo common stock held by persons and entities that held such shares prior to our merger with Algos. Endo Pharma LLC is a limited liability company that held approximately 15% of our common stock at December 31, 2005, but less than 1% of our common stock as of June 30, 2007, in which affiliates of Kelso & Company and certain current and former members of management have an interest. Upon the exercise of these stock options, only currently outstanding shares of our common stock held by Endo Pharma LLC have been and will be delivered. Because Endo Pharma LLC, and not us, has been and will provide the shares upon the exercise of these options, we have entered into a tax sharing agreement (as amended) with Endo Pharma LLC under which we are required to pay to Endo Pharma LLC the amount of the tax benefits usable by us as a result of the exercise of these stock options into shares of our common stock held by Endo Pharma LLC. As of June 30, 2007, approximately 36 million of these stock options had been exercised into shares of our common stock held by Endo Pharma LLC. Upon exercise of any of these Endo Pharma LLC stock options, we generally will be permitted to deduct as a compensation charge, for federal income tax purposes, an amount equal to the difference between the market price of our common stock and the exercise price paid upon exercise of these options (as of June 30, 2007, approximately $775 million), which is estimated to result in a tax benefit amount of approximately $299 million. Under the tax sharing agreement, we are required to pay this $299 million, $272 million of which has already been paid as of June 30, 2007, to Endo Pharma LLC to the extent that a compensation charge deduction is usable by us to reduce our taxes and based upon the assumption that all other deductions of Endo are used prior thereto. Additionally, as part of the tax sharing agreement, Endo Pharma LLC will reimburse us for the after-tax employer payroll taxes paid by us as a result of the exercise of the 36 million options discussed above. We have paid approximately $12 million in employer payroll taxes, of which Endo Pharma LLC will reimburse us for approximately $7 million, which represents the after-tax employer payroll tax paid by us for the periods from 2001 through June 30, 2007. As of June 30, 2007, our net liability due to Endo Pharma LLC is approximately $19.3 million. All payments made and accrued pursuant to the tax sharing agreement have been reflected as a reduction of stockholders equity in the accompanying financial statements.

During the six months ended June 30, 2007, approximately 70,000 shares underlying stock options granted under the Endo Pharma LLC stock option plans were exercised. Since we expect the attributable compensation charge deductions to be usable to reduce our taxes in 2007, we are obligated, under our amended tax sharing agreement, to pay to Endo Pharma LLC an additional tax benefit amount of approximately $0.8 million, which is included in our net liability due to Endo Pharma LLC referred to above. Fifty percent of the estimated tax benefit amount attributable to these exercises and any additional tax benefits attributable to the exercise of stock options granted under the Endo Pharma LLC stock option plans in 2007 will be due within 15 business days of the date we receive a report on our final audited 2007 financial statements from our independent registered public accounting firm, and the remaining tax benefit amount attributable to 2007 is due within 30 business days of the date on which we file our 2007 tax return with the Internal Revenue Service.

As of June 30, 2007, there were 5,335 stock options, which expire in August 2007, remaining to be exercised under the Endo Pharma LLC stock option plans. Using a weighted average exercise price of $2.42 per share and an assumed tax rate of 38.25%, if all of these remaining stock

options under the Endo Pharma LLC stock option plans were vested and exercised, and assuming the price of our common stock was $34.23 per share, the closing price on June 29, 2007, we would generally be able to deduct, for income tax purposes, compensation of approximately $0.2 million, which could result in a tax benefit

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amount of approximately $0.1 million payable to Endo Pharma LLC in 2008. This would represent the final tax sharing payment due to Endo Pharma LLC.

As of June 30, 2007, there were no options remaining to be granted under the Endo Pharma LLC stock option plans.

Executive Compensation. In March 2006, Endo Pharma LLC advised our Board of Directors that it intended to pay a one-time cash bonus to each of Mr. Peter Lankau, our President and Chief Executive Officer, Ms. Caroline Manogue, our Executive Vice President, Chief Legal Officer and Secretary, and Mr. Jeffrey Black, our former Executive Vice President, Chief Financial Officer and Treasurer in the amount of $3 million, $6 million and $10 million, respectively, in recognition of their significant contributions to our success. These bonus payments have been recorded in selling, general and administrative expenses during the year ended December 31, 2006. These payments were made by the Company in April 2006 and repaid to us by Endo Pharma LLC in the third quarter of 2006 with interest. In addition, only a portion of these bonus payments will be deductible for federal and state income tax purposes. We are not required to pay nor will we pay to Endo Pharma LLC the amount of any of the tax benefits related to these bonus payments pursuant to the tax sharing agreement between us and Endo Pharma LLC. These bonuses will be funded entirely by Endo Pharma LLC, with no contribution by us and they have been treated as a capital contribution by Endo Pharma LLC.

Endo Pharma LLC also informed us that, in connection with its eventual winding-up, it would make a special allocation to Ms. Carol Ammon, our Chairman of the Board and former Chief Executive Officer, of approximately $22 million, with all or a portion of Ms. Ammon s payment being satisfied by granting to her the remaining unallocated Endo Pharma LLC stock options of approximately 0.8 million shares under the Endo Pharma LLC stock option plans. This amount has been recorded in selling, general and administrative expenses during the year ended December 31, 2006 and as a capital contribution by Endo Pharma LLC. This grant of options to Ms. Ammon was made during the fourth quarter of 2006. The 0.8 million options were granted by Endo Pharma LLC to Ms. Ammon in the fourth quarter of 2006, as described above, at an exercise price of $2.42 per share. Therefore, approximately $20 million of the approximately $22 million recorded in the first quarter of 2006 was reclassified as a stock compensation expense representing the fair value of the option on the date of grant. These options were immediately vested and exercised by Ms. Ammon and the resulting compensation charge deduction of approximately $19 million and the resulting tax sharing obligation to Endo Pharma LLC is included in our tax sharing liability discussed above. Endo Pharma LLC funded the remaining $2 million to Ms. Ammon in June 2007.

Related Party Matters. Robert Ammon, the brother of our former Chairman and Chief Executive Officer, is employed by the Company as a senior national account executive and has been since the company s founding as a private company in 1997. It is expected that his 2007 total compensation, including base salary, incentive compensation, long-term incentive compensation and all benefits (including health benefits), will be in excess of $120,000 but will not exceed $255,000. Marisa Lankau, the daughter of our President and Chief Executive Officer, is employed by the Company as a sales representative and has been since 2006. It is expected that her 2007 total compensation, including base salary, incentive compensation, long-term incentive compensation and all benefits (including health benefits), may be in excess of $120,000 but will not exceed $125,000.

11. COMMITMENTS AND CONTINGENCIES

Manufacturing, Supply and Other Service Agreements We contract with various third party manufacturers and suppliers to provide us with our raw materials used in our products and finished goods. Our most significant agreements are with Novartis Consumer Health, Inc., Teikoku Seiyaku Co., Ltd., and Mallinckrodt Inc. If for any reason we are unable to obtain sufficient quantities of any of the finished goods or raw materials or components required for our products, this may have a material adverse effect on our business, financial condition and results of operations.

Novartis Consumer Health, Inc.

On May 3, 2001, we entered into a long-term manufacturing and development agreement with Novartis Consumer Health, Inc. whereby Novartis has agreed to manufacture certain of our commercial products and products in development. We are required to purchase, on an annual basis, a minimum amount of product from Novartis. The purchase price per product is equal to a predetermined amount per unit, subject to periodic adjustments. This agreement had a five-year term, with automatic five-year renewals thereafter. In August 2005, we extended this agreement until 2011. We are required to purchase a minimum of approximately $17 million per year through December 31, 2009. Either party may terminate this agreement on three-years notice, effective at any time after December 31, 2006. Either party may also terminate this agreement on account of a material breach by the other.

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Teikoku Seiyaku Co., Ltd.

Under the terms of this agreement, Teikoku, a Japanese manufacturer, manufactures Lidoderm® at its Japanese facility for commercial sale by us in the United States. We also have an option to extend the supply area to other territories. On April 24, 2007, we amended this agreement. The material components of the Amended Agreement are as follows:

We have agreed to purchase a certain number of patches per year for each year in the remaining term of the amended agreement.

Teikoku has agreed to fix the price of the Product for a period time after which the price will be adjusted at future dates certain based on a price index defined in the amended agreement.

Following cessation of our obligation to pay royalties to Hind Healthcare Inc. (Hind) under the Sole and Exclusive License Agreement dated as of November 23, 1998, as amended, between Hind and Endo, we will pay to Teikoku annual royalties based on our annual net sales of the Product.

The amended agreement will expire on December 31, 2021, unless terminated in accordance with its terms. After December 31, 2021, the amended agreement shall be automatically renewed on the first day of January each year unless (i) we and Teikoku agree to terminate the amended agreement upon mutual written agreement or (ii) either we or Teikoku terminates the amended agreement with 180-day written notice to the other party, which notice shall not in any event be effective prior to July 1, 2022.

Mallinckrodt Inc.

Under the terms of this agreement, Mallinckrodt manufactures and supplies to us narcotic active drug substances for inclusion in our controlled substance pharmaceutical products. We are required to purchase a fixed percentage of our annual requirements of each narcotic active drug substance from Mallinckrodt. The purchase price for these substances is equal to a fixed amount, adjusted on an annual basis. The initial term of this agreement is July 1, 1998 until June 30, 2013, with an automatic renewal provision for unlimited successive one-year periods. Either party may terminate this agreement for a material breach.

Properties

In June 2007, we agreed to provide approximately $2.7 million in funding for certain tenant improvements to be made at a building currently under construction at the Company s corporate headquarters in Chadds Ford, PA, which will be leased by the Company upon completion. The payments are to be made in two equal installments, the first of which was paid in July 2007 with the remainder to be paid upon completion of the building currently anticipated to be in the second half of 2008.

General

In addition to the manufacturing and supply agreements described above, we have agreements with (1) UPS Supply Chain Solutions, Inc. (f/d/b/a Livingston Healthcare Services, Inc.) for customer service support, warehouse and distribution services and certain financial functions that expires in 2010, (2) Kunitz and Associates Inc. for assistance with adverse event reporting and (3) PPD Development, LP for clinical development services, business development support, medical information services and adverse event reporting. Although we have no reason to believe that these agreements will not be honored, failure by any of these third parties to honor their contractual obligations may have a materially adverse effect on our business, financial condition and results of operations.

License Agreements, Milestones and Royalties

Hind Healthcare Inc.

Under the terms of the Hind License Agreement, royalties are recorded as a reduction to net sales due to the nature of the license agreement and the characteristics of the license involvement by Hind in Lidoderm®. The royalty rate is 10% of net sales through the shorter of (1) the expiration

of the last licensed patent or (2) November 20, 2011, including a minimum royalty of at least $500,000 per year. During the three months ended June 30, 2007 and 2006, we recorded $18.7 million and $15.6 million, respectively, for these royalties payable to Hind. During the six months ended June 30, 2007 and 2006, we recorded $35.8 million and $29.4 million, respectively, for these royalties payable to Hind.

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Penwest Pharmaceuticals

In January 2007, the Company and Penwest entered into an amendment (the 2007 Amendment) to the 2002 amended and restated strategic alliance agreement between the parties (the 2002 Agreement). Under the terms of the 2007 Amendment, Endo and Penwest agreed to restructure the 2002 Agreement to provide that royalties payable to Penwest for U.S. sales of Opana® ER will be calculated based on net sales of the product rather than on operating profit, and to change certain other provisions of the 2002 Agreement. The 2007 Amendment also resolves the parties ongoing disagreement with regard to sharing of marketing expenses during the period prior to when Opana® ER reaches profitability. The key financial terms of the 2007 Amendment are summarized as follows:

- With respect to U.S. sales of Opana® ER, Endo s royalty payments to Penwest will be calculated starting at 22% of annual net sales of the product, and, based on agreed-upon levels of annual net sales achieved, the royalty rate can increase to a maximum of 30%.

- No royalty payments will be due to Penwest for the first $41 million of royalties that would otherwise have been payable beginning from the time of the product launch in July 2006.

- Penwest is entitled to receive milestone payments of up to $90 million based upon the achievement of certain agreed-upon annual sales thresholds.

- In 2003, Penwest opted out of funding development costs for Opana® ER. Under the 2007 Amendment, the parties have agreed that Penwest s share of these unfunded development costs will be fixed at $28 million and will be recouped by Endo through a temporary 50% reduction in royalties payable to Penwest. This temporary reduction in royalties will not apply until the $41 million royalty threshold referred to above has been met.

As a result of the terms described above, the Company anticipates that no royalties are or will be due on the first $186.3 million of net sales of Opana® ER as we recoup our previously recognized launch expenses. After this initial $186.3 million of net sales, royalties will be reduced by fifty percent (50%) until we recoup our previously recognized certification period expenses, after which time royalties will be payable on annual net sales based on the royalty rates described above.

DURECT Corporation

In April 2007, DURECT and Endo entered into Amendment No. 4 to the Development, Commercialization and Supply License Agreement dated November 8, 2002 (the DURECT CHRONOGESIC™ License Agreement). Under Amendment No. 4, Endo shall not be responsible for any development costs for the CHRONOGESIC™ product candidate prior to May 1, 2008. Commencing on May 1, 2008, unless the DURECT CHRONOGESIC™ License Agreement is earlier terminated by Endo, Endo will fund 50% of the ongoing development costs for the CHRONOGESIC™ product candidate in accordance with the terms of the DURECT CHRONOGESIC™ License Agreement. Endo will also reimburse DURECT for a portion of its prior development costs upon the achievement of certain milestones. Milestone payments made by Endo under the DURECT CHRONOGESIC License Agreement could total up to $52.0 million. Endo and DURECT will share profits equally, based on projected financial performance of CHRONOGESIC . With respect to termination rights, the DURECT CHRONOGESIC License Agreement permits Endo to terminate its continued participation under a number of circumstances, one of which could require Endo to pay DURECT up to $10.0 million.

In addition, in March 2005, we signed an agreement that gives us the exclusive license to develop and commercialize DURECT s sufentanil-containing transdermal patch in the U.S. and Canada (the DURECT Sufentanil Agreement). Under the terms of the DURECT Sufentanil Agreement, in April 2005, we paid DURECT a $10 million upfront fee, which was expensed as research and development, and are subject to potential additional payment requirements of up to approximately $35 million upon achievement of predetermined regulatory and commercial milestones. We will also pay royalties to DURECT on net sales of the sufentanil transdermal patch. The DURECT Sufentanil Agreement provides each party with specified termination rights, including the right of each party to terminate the DURECT Sufentanil Agreement upon material breach of the DURECT Sufentanil Agreement by the other party and the right of Endo to terminate the DURECT Sufentanil Agreement at any time without cause subject to a specified notice period.

EpiCept Corp.

Our license agreement with EpiCept provides for Endo to pay EpiCept milestones as well as royalties on the net sales of EpiCept s LidoPAIN® BP product. EpiCept has also retained an option to co-promote the LidoPAIN® BP product. Under this agreement, Endo also received an exclusive, worldwide license to certain patents of EpiCept Corp. Milestone payments made by Endo under this agreement, including regulatory milestones and sales thresholds, could total up to $82.5 million.

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Vernalis Development Limited

Under the terms of the license agreement with Vernalis, we could be required to make a $40 million milestone payment upon FDA approval for the menstrual migraine indication (MM). In addition, Vernalis could receive one-time milestone payments for achieving defined annual net sales targets. These sales milestone payments increase based on increasing net sales targets ranging from a milestone of $10 million on $200 million in net sales to a milestone of $75 million on $1.2 billion in net sales. These sales milestones could total up to $255