ENDO PHARMACEUTICALS HOLDINGS INC
Form 10-Q
May 14, 2002

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2002 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: 39040

ENDO PHARMACEUTICALS HOLDINGS INC.

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

Indicate by check 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 NO

The aggregate number of shares of the Registrant s common stock outstanding as of May 14, 2002 was 102,064,450.

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ENDO PHARMACEUTICALS HOLDINGS INC.

REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002

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Forward Looking Statements

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

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

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

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PART I

FINANCIAL INFORMATION

Item 1. ***Financial Statements***

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

	March 31, 2002	December 31, 2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$117,695	$95,357
Accounts receivable, net	69,953	85,329
Inventories	30,565	27,766
Prepaid expenses	3,999	5,527
Deferred income taxes	28,067	26,946
Total current assets	250,279	240,925
PROPERTY AND EQUIPMENT, Net	9,364	9,883
GOODWILL	181,079	182,318
OTHER INTANGIBLES, Net	12,311	12,495
DEFERRED INCOME TAXES	20,418	23,420

RESTRICTED CASH	150	150
OTHER ASSETS	1,874	1,804
TOTAL ASSETS	$475,475	$470,995

LIABILITIES AND STOCKHOLDERS EQUITY

CURRENT LIABILITIES:		
Accounts payable	$28,595	$30,705
Accrued expenses	59,693	50,176
Income taxes payable	233	3,526
Current portion of long-term debt	92,968	91,259
Total current liabilities	181,489	175,666
OTHER LIABILITIES	218	207
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		

Preferred Stock, $.01 par value; 40,000,000 shares authorized; none issued		
Common Stock, $.01 par value; 175,000,000 shares authorized; and 102,063,950 issued and outstanding at March 31, 2002 and December 31, 2001	1,021	1,021
Additional paid-in capital	512,586	519,316
Accumulated deficit	(219,839)	(225,215)
Total Stockholders Equity	293,768	295,122
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$475,475	$470,995

See Notes to Consolidated Financial Statements

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

	Three Months Ended March 31,	
	2002	**2001**
NET SALES	$ 67,026	$ 39,382
COST OF SALES	18,891	12,649
GROSS PROFIT	48,135	26,733
COSTS AND EXPENSES:		
Selling, general and administrative	23,583	15,890
Research and development	13,396	9,174
Depreciation and amortization	785	12,399
OPERATING INCOME (LOSS)	10,371	(10,730)
INTEREST EXPENSE, Net of interest income of $307 and $1,089, respectively	1,622	3,540

INCOME (LOSS) BEFORE INCOME TAX (BENEFIT)	8,749	(14,270)
INCOME TAX (BENEFIT)	3,373	(32)
NET INCOME (LOSS)	$5,376	$(14,238)
NET INCOME (LOSS) PER SHARE:		
Basic	$ .05	$(.16)
Diluted	$ .05	$(.16)
NET INCOME (LOSS) PRO FORMA TO EXCLUDE AMORTIZATION OF GOODWILL AND WORKFORCE-IN-PLACE:	$5,376	$(1,572)
NET INCOME (LOSS) PER SHARE PRO FORMA TO EXCLUDE AMORTIZATION OF GOODWILL AND WORKFORCE-IN-PLACE:		
Basic	$.05	$(.02)

Diluted	$.05	$(.02)
WEIGHTED AVERAGE SHARES:		
Basic	102,064	89,139
Diluted	102,281	89,139

See Notes to Consolidated Financial Statements.

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

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
OPERATING ACTIVITIES:		
Net Income (Loss)	$5,376	$(14,238)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	785	12,399
Amortization of deferred financing costs	80	547
Accretion of promissory notes	1,708	1,178
Deferred income taxes	3,120	(35)
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable	15,376	26,715
Inventories	(2,799)	(174)
Other assets	1,378	541
Accounts payable	(2,110)	864
Accrued expenses	9,516	(5,463)
Income taxes payable	(3,293)	(2,549)
Other liabilities	11	5,441
Net cash provided by operating activities	29,148	25,226

INVESTING ACTIVITIES:		
Purchase of property and equipment	(80)	(1,240)
Net cash used in investing activities	(80)	(1,240)
FINANCING ACTIVITIES:		
Repayments of long-term debt		(4,127)
Repurchase of Class A Transferable and Class B Non-Transferable Warrants	(6,730)	
Net cash used in financing activities	(6,730)	(4,127)
NET INCREASE IN CASH AND CASH EQUIVALENTS	22,338	19,859
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	95,357	59,196

CASH AND CASH EQUIVALENTS, END OF PERIOD	$117,695	$79,055
SUPPLEMENTAL INFORMATION:		
Interest Paid	$20	$2,861
Income Taxes Paid	$3,293	$2,786

See Notes to Consolidated Financial Statements.

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ENDO PHARMACEUTICALS HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FOR THE THREE MONTHS ENDED MARCH 31, 2002

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the accompanying condensed consolidated financial statements of Endo Pharmaceuticals Holdings Inc. (the Company or we) and its subsidiaries, which are unaudited, include all normal and recurring adjustments necessary to present fairly the Company s financial position as of March 31, 2002 and the results of operations and cash flows for the periods presented. The accompanying consolidated balance sheet as of December 31, 2001 is derived from the Company s audited financial statements. Certain information and footnote disclosure normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted as promulgated by APB Opinion No. 28 and Rule 10.01 of Regulation S-X. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto as of and for the year ended December 31, 2001 contained in the Company s Annual Report on Form 10-K. Certain reclassifications have been made to the prior period s financial statements to conform with the classifications used in 2002.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which was effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended by SFAS 137 and SFAS 138, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated in a fair value hedge, the changes in the fair value of the derivative and the hedged item are recognized in earnings. If the derivative is designated as a cash flow hedge, changes in the fair value of the derivative are recorded in other comprehensive income (OCI) and are recognized in the income statement when the hedged item affects earnings. SFAS 133 defines new requirements for designation and documentation of hedging relationships as well as ongoing effectiveness assessments in order to use hedge accounting. A derivative that does not qualify as a hedge is marked to fair value through earnings.

At January 1, 2001, we recorded $228,000 as an accumulated transition adjustment as a reduction to earnings.

In December 1999, the SEC issued SAB 101, entitled Revenue Recognition in Financial Statements, as amended, effective as of October 1, 2000, which summarizes the SEC s views in applying generally accepted accounting principles to revenue recognition. The adoption of this guideline had no effect on our financial statements.

In March 2000, the FASB issued Financial Accounting Series Interpretation No. 44 entitled Accounting for Certain Transactions involving Stock Compensation, which provides clarification to Accounting Principles Board Opinion No. 25 (APB No. 25), Accounting for Stock Issued to Employees. The adoption of this interpretation had no effect on our financial statements.

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

3. GOODWILL AND OTHER INTANGIBLES

Effective January 1, 2002, we adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets.

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

	March 31, 2002	December 31, 2001
Goodwill	$181,079	$182,318
Amortizable Intangibles:		
Licenses	$11,000	$11,000
Patents	3,200	3,200
	14,200	14,200
Less accumulated amortization	(1,889)	(1,705)
Other Intangibles, net	$12,311	$12,495

We have one reportable segment, pharmaceutical products. Goodwill arose as a result of the August 26, 1997 acquisition of certain branded and generic pharmaceutical products, related rights and certain assets of DuPont Pharmaceuticals Company (DuPont , formerly The DuPont Merck Pharmaceutical Company, DuPont Merck Pharma and Endo Laboratories, L.L.C.) and the July 17, 2000 acquisition of Algos Pharmaceutical Corporation (Algos). Although goodwill arose in two separate transactions, the components of our operating segment have been integrated and are managed as one reporting unit. Our components extensively share assets and other resources with the other components of our business.. In addition, our components do not maintain discrete financial information. Accordingly, the components of our business have been aggregated into one reporting unit and will be evaluated as such for goodwill impairment. Goodwill will be evaluated for impairment on an annual basis on January 1st of each year unless events or circumstances indicate that an impairment has occurred between annual dates. Goodwill has been evaluated for impairment upon the adoption of SFAS No. 142 and no impairment has been identified.

Effective January 1, 2002, the carrying amount of workforce-in-place was reclassified as goodwill. The cost of license fees is capitalized and is being amortized on a straight-line basis over their estimated useful life of twenty years. The cost of acquired patents is capitalized and is being amortized on a straight-line basis over their estimated useful life of seventeen years.

The pro forma effect of the adoption of SFAS No. 141 and SFAS No. 142 is as follows: