ENDO PHARMACEUTICALS HOLDINGS INC
Form 10-Q
November 14, 2001

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 September 30, 2001

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 |X| 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 |_|

The aggregate number of shares of the Registrant's common stock outstanding as of November 14, 2001 was 100,538,950.

ENDO PHARMACEUTICALS HOLDINGS INC.

REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

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Forward-Looking Statements

This Report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on management's beliefs and assumptions, current expectations, estimates and projections. These statements are subject to risks and uncertainties and, therefore, actual results may differ materially from those expressed or implied by these forward-looking statements. Forward-looking statements are not historical facts and include information regarding the Company's possible or assumed results of operations. Also, statements or expressions that are preceded by, followed by, or that include, the words "believes," "anticipates," "plans," "expects," "intends," "estimates" or similar expressions are forward-looking statements. Endo's estimated or anticipated future results, product performance or other non-historical facts are forward-looking and reflect Endo's current perspective on existing trends and information. Many of the factors that will determine the Company's future results are beyond the ability of the Company to control or predict. The reader should not rely on any forward-looking statement. The Company undertakes no obligations to update any forward-looking statements whether as a result of new information, future events or otherwise. Several important factors, in addition to the specific factors discussed in connection with these forward-looking statements individually, could affect the future results of Endo and could cause those results to differ materially from those expressed in the forward-looking statements contained herein. Important factors that may affect future results include, but are not limited to:

|X| the Company's ability to successfully develop, commercialize and market new products;

|X| results of clinical trials on new products;

|X| competition for the business of the Company's branded and generic products, and in connection with the Company's acquisition of rights to intellectual property assets;

|X| market acceptance of the Company's future products;

|X| government regulation of the pharmaceutical industry;

|X| the Company's dependence on a small number of products;

|X| the Company's dependence on outside manufacturers for the manufacture of its products;

|X| the Company's dependence on third parties to supply raw materials and to provide services for the core aspects of its business;

|X| new regulatory action or lawsuits relating to the Company's use of narcotics in most of its core products;

|X| the Company's exposure to product liability claims and product recalls

and the possibility that the Company may not be able to adequately insure itself;

|X| the Company's ability to protect its proprietary technology;

|X| the Company's ability to successfully implement its acquisition strategy;

|X| the availability of controlled substances that constitute the active ingredients of some of the Company's products and products in development;

|X| the availability of third-party reimbursement for the Company's products;

|X| the Company's dependence on sales to a limited number of large pharmacy chains and wholesale drug distributors for a large portion of its total net sales; and

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other risks and uncertainties detailed in Endo's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on June 9, 2000, as amended, and in Endo's Registration Statement on Form S-3 dated October 17, 2001. Readers should evaluate any statement in light of these important factors.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2001	December 31, 2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 89,309	$ 59,196
Accounts receivable, net	79,419	78,312
Inventories	20,257	29,746
Prepaid expenses	2,731	3,496
Deferred income taxes	2,161	2,304
Total current assets	193,877	173,054
PROPERTY AND EQUIPMENT, Net	9,086	5,742
GOODWILL AND OTHER INTANGIBLES, Net	245,519	284,560
DEFERRED INCOME TAXES	1,979	736
RESTRICTED CASH	150	150
OTHER ASSETS	5,571	3,598
TOTAL ASSETS	$456,182	$467,840

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable	$ 21,370	$ 15,855
Accrued expenses	50,862	45,520
Income taxes payable	185	2,549
Current portion of long-term debt	16,140	36,371
Total current liabilities	88,557	100,295
LONG-TERM DEBT, Less current portion	174,516	162,154
OTHER LIABILITIES	2,183	7,218
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 89,138,950 issued and outstanding at September 30, 2001 and December 31, 2000	891	891
Additional paid-in capital	423,208	385,955
Accumulated deficit	(233,173)	(188,673)
Total Stockholders' Equity	190,926	198,173
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$456,182	$467,840

See Notes to Consolidated Financial Statements

ENDO PHARMACEUTICALS HOLDINGS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(In thousands, except per share data)

	Three Months Ended September 30,		
	2001	2000	
NET SALES	$ 66,268	$ 50,902	$
COST OF SALES	20,622	15,254	
GROSS PROFIT	45,646	35,648	
COSTS AND EXPENSES:			
Selling, general and administrative	19,588	14,564	
Research and development	7,886	8,315	
Depreciation and amortization	12,394	10,715	
Compensation related to stock options - primarily			

selling, general and administrative	37,253		
Purchased in-process research and development		133,200	
Merger and other related costs		1,583	
Separation benefits			
OPERATING INCOME (LOSS)	(31,475)	(132,729)	
INTEREST EXPENSE, Net of interest income of $607, $782, $2,423 and $1,809, respectively	2,686	3,672	
LOSS BEFORE INCOME TAX (BENEFIT)	(34,161)	(136,401)	
INCOME TAX (BENEFIT)	(1,168)	147	
NET LOSS	$(32,993)	$(136,548)	$
NET LOSS PER SHARE:			
Net Loss per Share:			
Basic	$ (.37)	$ (1.59)	$
Diluted	$ (.37)	$ (1.59)	$
Weighted Average Shares:			
Basic	89,139	85,848	
Diluted	89,139	85,848	

See Notes to Consolidated Financial Statements.

ENDO PHARMACEUTICALS HOLDINGS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

N

OPERATING ACTIVITIES:	
Net Loss	$ (4
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation and amortization	3
Purchased in-process research and development	
Amortization of deferred financing costs	
Accretion of promissory notes	
Deferred income taxes	(1
Compensation related to stock options	3
Changes in assets and liabilities which provided (used) cash:	
Accounts receivable	(1
Inventories	
Other assets	(2
Accounts payable	

Accrued expenses	
Income taxes payable	(2
Other liabilities	16
Net cash provided by operating activities	67
INVESTING ACTIVITIES:	
Purchase of property and equipment	(4
Net cash acquired in the Merger	
Net cash (used in) provided by investing activities	(4
FINANCING ACTIVITIES:	
Repayments of long-term debt	(32
Issuance of Class A Common Stock on March 6, 2000	
Net cash used in financing activities	(32
NET INCREASE IN CASH AND CASH EQUIVALENTS	30
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	59
CASH AND CASH EQUIVALENTS, END OF PERIOD	$89
SUPPLEMENTAL INFORMATION:	
Interest Paid	$ 6
Income Taxes Paid	$ 2
SCHEDULE OF NON-CASH INVESTING AND FINANCIAL ACTIVITIES	
Promissory Note issued under Manufacturing & Supply Agreement	$21
Fair value of net assets acquired in the Merger, net of cash	
Adjustment to fair value of net assets acquired in the Merger due to lease termination	$3,

See Notes to Consolidated Financial Statements.

ENDO PHARMACEUTICALS HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001

1. CONSOLIDATED FINANCIAL STATEMENTS

In the opinion of management, the accompanying condensed consolidated financial statements of Endo Pharmaceuticals Holdings Inc. ("Endo" or the "Company") and its subsidiaries, which are unaudited, include all normal and recurring adjustments necessary to present fairly the Company's financial position as of September 30, 2001 and the results of operations and cash flows for the periods presented. The accompanying consolidated balance sheet as of December 31, 2000 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 promulgated under the Securities Act of 1933. 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, 2000 contained in the Company's Annual Report on Form 10-K filed on March 29, 2001.

2. MERGER

On November 29, 1999, the Company and Algos Pharmaceutical Corporation ("Algos") announced that they had entered into a definitive merger agreement providing for the merger (the "Merger") of Algos into Endo Inc., a newly formed, wholly owned subsidiary of the Company. The Merger, which was completed on July 17, 2000, has been accounted for by the Company using the purchase method of accounting. The assets acquired and liabilities assumed of Algos were recorded at their fair values at the date of acquisition based on an independent appraisal. The assets acquired and liabilities assumed, results of operations and cash flows of Algos have been included in the Company's financial statements prospectively for reporting periods beginning July 17, 2000.

The total purchase price of $248.6 million (including approximately $7.0 million in transaction fees) was determined using an average closing price of the Algos common stock for a reasonable period of time before and after the April 17, 2000 measurement date of $13.54 and the 17,832,106 common shares and common share equivalents of Algos outstanding at the date of the Merger (including 21,580 outstanding Algos Series A Warrants). The allocation of the fair value of the assets acquired and liabilities assumed includes an allocation to workforce in place of $11.9 million which is being amortized over its estimated useful life of two years, patents of $3.2 million which is being amortized over their estimated useful lives of 17 years and goodwill of $104.8 million which is being amortized over its estimated useful life of three years. In addition, the Company recorded estimated liabilities for exit costs of $3.1 million related to non-cancelable lease payments and $1.1 million for employee relocation costs. In the third quarter of 2001, the Company was released from its obligation under lease payments on the former Algos corporate offices. Accordingly, this estimated liability for exit costs of $3.1 million was reversed and recorded as a reduction in goodwill. The balance of the estimated liabilities for exit costs is $1.0 million as of September 30, 2001. Also, as a result of the Merger, it was determined that the utilization of the Company's federal deferred tax assets is uncertain. Accordingly, a valuation allowance has been recorded to fully reserve the Company's federal deferred tax assets.

The Merger included various on-going projects to research and develop innovative new products for pain management. As a result, the allocation of the fair value of the assets acquired and liabilities assumed includes an allocation to purchased in-process research and development ("IPRD") of $133.2 million which was immediately expensed in the consolidated statement of operations on the acquisition date. The methodology used by the Company on the acquisition date in determining the value of IPRD was to: 1) identify the various on-going projects that the Company will prioritize and continue; 2) project net future cash flows of the identified projects based on current demand and pricing assumptions, less the anticipated expenses to complete the development program, drug application, and launch the products (significant net cash inflows from MorphiDex(R) were projected in 2003); 3) discount these cash flows based on a risk-adjusted discount rates ranging from 25% to 33% (weighted average discount rate of 27%); and 4) apply the

estimated percentage of completion to the discounted cash flow for each individual project ranging from 4% to 81%. The discount rate was determined after considering various uncertainties at the time of the Merger, primarily the stage of project completion.

The Company allocated fair value to the three opioid analgesic projects of Algos: MorphiDex(R), HydrocoDexTM and OxycoDexTM. The development program for a new pharmaceutical substance involves several different phases prior to submission of an application with the appropriate governmental agency for approval. Such application must be approved prior to marketing a new drug. Despite the Company's commitment to completion of the research and development projects, many factors may arise that could cause a project to be withdrawn or delayed, including the inability to prove the safety and efficacy of a drug during the development process. Upon withdrawal, it is unlikely that the development activities will have alternative use. If these projects are not successfully developed, the Company's results of operations and financial position in a future period could be negatively impacted.

3. RECAPITALIZATION

In connection with the Merger, the Company effected a recapitalization (the "Recapitalization") of its common stock, par value $.01 per share ("Common Stock"), class A common stock, par value $.01 per share ("Class A Common Stock") and preferred stock. The Recapitalization was effected on July 17, 2000 through a stock dividend of approximately 64.59 shares of Common Stock for each share of Common Stock and Class A Common Stock outstanding immediately prior to the Merger. Immediately prior to the Merger, the Company amended and restated its certificate of incorporation to effect the Recapitalization and to eliminate its Class A Common Stock. The effect of the Recapitalization has been reflected in the accompanying financial statements.

4. RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities, which is 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 on-going effectiveness assessments in order to use hedge accounting. A derivative that does not qualify as a hedge will be marked to fair value through earnings.

At January 1, 2001, the Company recorded $0.2 million as an accumulated transition adjustment as a reduction to earnings relating to cash flow hedges.

In December 1999, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin, 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 the Company's 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 the Company's 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 is 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. Upon adoption, the Company will no longer amortize goodwill unless evidence of an impairment exists. Goodwill will be evaluated for impairment on at least an annual basis. Although the Company is currently evaluating all of the provisions of SFAS No. 141 and SFAS No. 142 and therefore is not presently able to quantify the impact of adoption, the Company does believe the adoption of SFAS No. 142 will have a material impact on its results of operations. The Company has $228.1 million of goodwill as of September 30, 2001 and has recorded $30.7 million of goodwill amortization for the nine months ended September 30, 2001. The Company will adopt the provisions of SFAS No. 142 effective January 1, 2002.

5. COMMITMENTS AND CONTINGENCIES

The Company has entered into employment agreements with certain members of management.

The Company is subject to various claims arising out of the normal course of business with respect to commercial matters, including product liabilities, patent infringement matters, governmental regulation and other actions. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the financial position, results of operations or liquidity of the Company.

Prior to July 17, 2000, Kelso & Company provided financial advisory services to the Company for an annual fee of $347,000 plus the reimbursement of expenses. In connection with the Merger, which was completed on July 17, 2000, the Company terminated this agreement by making a one-time payment to Kelso of $1.5 million, which was charged to expenses as of July 17, 2000.

6. COMPENSATION RELATED TO STOCK OPTIONS

During the period ended September 30, 2001, the Company recorded a non-cash charge of $37.3 million for stock-based compensation relating to the vesting of options that were granted under the Endo Pharma LLC Amended and Restated 1997 Stock Option Plans. Under these plans, tranches of options vest when the Company attains certain stock price targets. As each tranche vests, the Company incurs a non-cash charge representing the difference between the market price of the shares of Common Stock

underlying the options and the exercise price of such options. The Company may in the future incur up to two additional charges in relation to the Endo Pharma LLC options. These charges may be substantial. These options are exercisable into shares of Common Stock that are presently held by Endo Pharma LLC. As a result, the exercise of these options will not result in the issuance of additional shares of Common Stock and will not dilute the public Endo stockholders.

7. SEPARATION BENEFITS

During the period ended March 31, 2000 and immediately thereafter, the Company entered into separation and release agreements with two executives. The agreements were accounted for during the period ended March 31, 2000 as all material terms and conditions were known as of March 31, 2000. Severance and other termination benefits provided by the agreements amounting to $1,252,000 were accrued as of March 31, 2000.

The separation and release agreements provided that certain options granted to the two executives under then existing option plans became fully vested on the effective dates of the agreements. The agreements also provided that other options previously granted to the executives would terminate. The agreements further provided terms and conditions for the exercise of the vested options. Cost related to stock options resulting from the agreements resulted in a charge to the Company of $20,782,000 during the period ended March 31, 2000.

8. SUBSEQUENT EVENTS

On October 23, 2001, the Company completed a public offering of 11.4 million primary shares of Common Stock. On October 29, 2001, the Company used the net proceeds of this public offering totaling $84.9 million together with $16.1 million of cash and cash equivalents to repay in full the term loans under its existing credit facility. In connection with the extinguishment of the term loans, the Company expensed approximately $2.4 million in deferred financing fees. This charge will be reflected as an extraordinary item, net of tax, in the Company's statement of operations in the fourth quarter of 2001.

The Company is currently negotiating the terms of a new senior secured credit facility with a number of lenders, including affiliates of certain of the underwriters of the recent public offering, to replace the Company's existing credit agreement. The Company currently expects the new credit facility to be in the amount of approximately $100 million and to have a final maturity of five years. Any outstanding loans under the new credit facility may be secured by a first priority security interest in substantially all of the Company's assets. The new credit facility is expected to contain representations and warranties, covenants, events of default and other provisions customarily found in similar agreements. The Company cannot assure you that it will be able to enter into the new credit facility on the terms described above or at all.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Except for the historical information contained in this Report, this Report, including the following discussion, contains forward-looking

statements that involve risks and uncertainties.

Overview

The Company, through its wholly owned subsidiaries, Endo Pharmaceuticals Inc. and Endo Inc., is engaged in the research, development, sales and marketing of branded and generic prescription pharmaceuticals used primarily for the treatment and management of pain. Branded products comprised approximately 68%, 76% and 67% of net sales for the year ended December 31, 1999, the year ended December 31, 2000 and the nine months ended September 30, 2001, respectively. On August 26, 1997, an affiliate of Kelso & Company and then members of management entered into an asset purchase agreement with the then DuPont Merck Pharmaceutical Company to acquire certain branded and generic pharmaceutical products and exclusive worldwide rights to a number of new chemical entities in the DuPont research and development pipeline from DuPont Merck through the newly-formed Endo Pharmaceuticals. On November 19, 1999, the Company formed Endo Inc. as a wholly owned subsidiary to effect the acquisition of Algos Pharmaceutical Corporation ("Algos"). The stock of Endo Pharmaceuticals Inc. and the stock of Endo Inc. are the only assets of the Company, and the Company has no other operations or business. The Company was formed as a holding company and incorporated on November 18, 1997 under the laws of the state of Delaware and has its principal executive offices at 100 Painters Drive, Chadds Ford, Pennsylvania 19317 (telephone number: (610) 558-9800).

On July 17, 2000, the Company completed its merger with Algos (the "Merger"). In the Merger, the Company issued to the former Algos stockholders, in the aggregate, 17,810,526 shares of Company Common Stock and 17,810,526 warrants to purchase in the aggregate up to 20,575,507 additional shares of Company Common Stock in certain circumstances as more fully described in the Company's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on June 9, 2000, as amended. In the Merger, the Company also issued to the pre-Merger Endo stockholders, in the aggregate, 71,328,424 warrants to purchase in the aggregate up to 29,720,177 additional shares of Common Stock in certain other circumstances as more fully described in the Company's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on June 9, 2000, as amended.

The Merger has been accounted for by the Company using the purchase method of accounting. The assets acquired and liabilities assumed of Algos have been recorded at their fair values based on an independent appraisal. The assets acquired and liabilities assumed, results of operations and cash flows of Algos have been included in the Company's financial statements and Management's Discussion and Analysis of Financial Conditions and Results of Operations prospectively for reporting periods beginning July 17, 2000.

The Merger included various on-going projects to research and develop innovative new products for pain management. As a result, the allocation of the fair value of the assets acquired and liabilities assumed includes an allocation to purchased in-process research and development ("IPRD") of $133.2 million which was immediately expensed in the consolidated statement of operations on the acquisition date. The methodology used by the Company on the acquisition date in determining the value of IPRD was to: 1) identify the various on-going projects that the Company will prioritize and continue; 2) project net future cash flows of the identified projects based on current demand and pricing assumptions, less the anticipated expenses to complete the development program, drug application, and launch the products (significant net cash inflows from MorphiDex(R) were projected in 2003); 3) discount these cash flows based on a risk-adjusted discount rates ranging from 25% to 33% (weighted average discount rate of 27%); and 4) apply the estimated percentage of completion to the discounted cash flow for each

individual project ranging from 4% to 81%. The discount rate was determined after considering various uncertainties at the time of the merger, primarily the stage of project completion.

The Company allocated fair value to the three opioid analgesic projects of Algos: MorphiDex(R), HydrocoDexTM and OxycoDexTM. The development program for a new pharmaceutical substance involves several different phases prior to submission of an application with the appropriate governmental agency for approval. Such application must be approved prior to marketing a new drug. Despite the Company's commitment to completion of the research and development projects, many factors may arise that could cause a project to be withdrawn or delayed, including the inability to prove the safety and efficacy of a drug during the development process. Upon withdrawal, it is unlikely that the development activities will have alternative use. If these projects are not successfully developed, the Company's results of operations and financial position in a future period could be negatively impacted.

The Company's quarterly results have fluctuated in the past, and may continue to fluctuate. These fluctuations are primarily due to the timing of new product launches, purchasing patterns of the Company's customers, market acceptance of the Company's products and the impact of competitive products and pricing.

Results of Operations

Net Sales

Net sales consist of revenues from sales of pharmaceutical products, less estimates for certain chargebacks, sales allowances, the cost of returns and losses. Net sales are recognized when products are shipped.

The following table presents unaudited net sales for select products for the three months and the nine months ended September 30, 2001 and 2000:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
	(in thousands, unaudited)			
Percocet(R)	$ 16,430	$ 23,379	$ 72,831	$54,251
Lidoderm(R)	16,268	7,343	26,933	12,833
Other Brands	8,087	8,330	16,678	21,311
Total Brands	$ 40,785	$39,052	$ 116,442	$88,395
Total Generics	25,483	11,850	57,065	31,441

Total Net Sales	$66,268	$50,902	$173,507	$119,836

The following table presents unaudited net sales as a percentage of total net sales for select products for the three months and nine months ended September 30, 2001 and 2000:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
	(unaudited)			
Percocet(R)	25%	46%	42%	45%
Lidoderm(R)	25%	15%	15%	11%
Other Brands	12%	16%	10%	18%
Total Brands	62%	77%	67%	74%
Total Generics	38%	23%	33%	26%
Total Net Sales	100%	100%	100%	100%

Goodwill and Other Intangibles

Goodwill and other intangibles represent a significant portion of the assets and stockholders' equity of the Company. As of September 30, 2001, goodwill and other intangibles comprised approximately 54% of total assets and 129% of stockholders' equity. The Company assesses the recoverability and the amortization period of goodwill by determining whether the amount can be recovered through undiscounted net cash flows of the businesses acquired over the remaining amortization period. The Company reviews for the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, such as in the event of a significant adverse change in business conditions or a significant change in the intended use of an asset. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset are less than its carrying amount. Assets are grouped at the lowest level for which there are identifiable cash flows that are largely independent from other asset groups. The Company uses the discounted future expected net cash flows, as its estimate of fair value, to determine the amount of impairment

loss. As a result of the significance of goodwill and other intangibles, amortization of goodwill and other intangibles will significantly impact the results of operations of the Company. In addition, the Company's results of operations and financial position in a future period could be negatively impacted should an impairment of goodwill and other intangible assets occur. See "Recent Accounting Pronouncements."

Compensation Related to Stock Options

In the third quarter of 2001 and the fourth quarter of 2000, the Company incurred non-cash charges of $37.3 million and a non-cash charge of $15.3 million, in each case for stock-based compensation relating to the vesting of options that were granted under the Endo Pharma LLC stock option plans. Under these plans, tranches of options vest when the Company attains certain stock price targets. As each tranche vests, the Company incurs a non-cash charge representing the difference between the market price of the shares of Common Stock underlying the options and the exercise price of such options. The Company may in the future incur up to two additional charges in relation to the Endo Pharma LLC options. These charges may be substantial. These options are exercisable into shares of Common Stock that are presently held by Endo Pharma LLC. As a result, the exercise of these options will not result in the issuance of additional shares of Common Stock and will not dilute the public stockholders of Endo.

All the options granted pursuant to the Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan have exercise prices equal to the market price of the Company Common Stock on the date granted and, under accounting principles generally accepted in the United States of America, a measurement date had occurred on the date of grant. Consequently, the Company does not expect to incur a charge upon the vesting or exercise of those options.

Three Months Ended September 30, 2001 Compared to the Three Months Ended September 30, 2000

Net Sales. Net sales for the three months ended September 30, 2001 increased by 30% to $66.3 million from $50.9 million in the comparable 2000 period. This increase in net sales was primarily due to the increase in net sales from Lidoderm(R) and certain generic products. Specifically, in September 1999, the Company launched Lidoderm(R), the first FDA-approved product for the treatment of the pain of post-herpetic neuralgia. In November 1998, the Company launched the 15mg, 30mg and 60mg strengths, in May 2001, the Company launched the 100mg strength and in September 2001, the Company launched the 200mg strength of its generic morphine sulfate extended release tablets. In the second quarter of 2001, the Company launched two new strengths of its generic product Endocet(R). The increase in net sales resulting from the foregoing launches were primarily offset by a decrease in net sales of Percocet(R). In April 2001, generic equivalents to Percocet(R) 7.5/500 and Percocet(R) 10.0/650 became available. These generics may have a material impact on the results of operations and cash flows of the Company in the future.

Gross Profit. Gross profit for the three months ended September 30, 2001 increased by 28% to $45.6 million from $35.6 million in the comparable 2000 period. Gross profit margins decreased to 69% from 70% in the comparable 2000 period due to an increase in the percentage of net sales attributable to generic products. Net sales of generic products for the three months ended September 30, 2001 increased to 38% of net sales from 17% of net sales in the comparable 2000 period. Although net sales of brand products increased 4% for the three months ended September 30, 2001 over the comparable 2000 period, generic products increased 115% in the three months ended September 30, 2001 over the comparable 2000 period due to the factors discussed above. If the Company achieves its forecast for revenue

and product mix, the Company's management expects an increase in gross profit and gross profit margin for fiscal year 2001 over fiscal year 2000.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended September 30, 2001 increased by 34% to $19.6 million from $14.6 million in the comparable 2000 period. This increase was due to a $2.1 million increase in sales and promotional efforts in 2001 over the comparable 2000 period to support Lidoderm(R) and Percocet(R). The increase in sales and promotional efforts was primarily due to the first quarter 2001 deployment of a dedicated contract sales force of 230 full-time representatives comprised of 70 full-time specialty representatives and 160 full-time primary care representatives compared to 300 part-time representatives in the comparable 2000 period. In addition, the Company experienced an increase in personnel-related costs in the general and administrative functions in order to support its growth.

Research and Development Expenses. Research and development expenses for the three months ended September 30, 2001 decreased by 6% to $7.8 million from $8.3 million in the comparable 2000 period. Research and development expenses in the three months ended September 30, 2000 included a significant portion of the cost to manufacture clinical supplies for ongoing trials.

Depreciation and Amortization. Depreciation and amortization for the three months ended September 30, 2001 increased to $12.4 million from $10.7 million in the comparable 2000 period. This increase was substantially due to the increase in amortization of goodwill and other intangibles resulting from the intangible assets acquired as a result of the Merger. The results of operations of Algos have been included in the Company's financial statements prospectively for reporting periods beginning July 17, 2000.

Compensation Related to Stock Options. Compensation related to stock options of $37.3 million reflects the charge arising from the vesting of performance-based stock options granted pursuant to the Endo Pharma LLC stock option plans. Under these plans, tranches of options vest when the Company attains certain Common Stock price targets. As each tranche vests, the Company incurs a non-cash charge representing the difference between the market price of the shares of Common Stock underlying the options and the exercise price of such options. The Company may in the future incur up to two additional charges in relation to the Endo Pharma LLC options. These charges may be substantial. These options are exercisable into shares of Common Stock that are presently held by Endo Pharma LLC. As a result, the exercise of these options will not result in the issuance of additional shares of Common Stock and will not dilute the public stockholders of Endo.

Purchased In-Process Research and Development. Purchased in-process research and development for the three months ended September 30, 2000 of $133.2 million resulted from the estimated fair value of the products under development that the Company acquired in the Merger with Algos.

Merger and Other Related Costs. Merger and other related costs for the three months ended September 30, 2000 of $1.6 million resulted from fees incurred as a result of the Merger with Algos that were not considered direct costs of the acquisition.

Consolidated EBITDA. Consolidated EBITDA for the three months ended September 30, 2001 increased 58% to $24.7 million from $15.6 million in the comparable 2000 period.

Interest Expense, Net. Interest expense, net for the three months ended September 30, 2001 decreased by 27% to $2.7 million from $3.7 million

in the comparable 2000 period. The decrease was primarily due to a decrease in interest expense of $1.0 million due to a decrease in interest rates.

Income Tax (Benefit). Income tax (benefit) for the three months ended September 30, 2001 increased as a result of an increase in the taxable loss and, for the three months ended September 30, 2001, reflects only state income tax benefit. The Company has recorded a valuation allowance on its existing federal deferred tax assets due to the uncertainty of the utilization of such amounts in the foreseeable future. The Company continually evaluates whether conditions exist that indicate that the utilization of deferred tax assets will be more likely than not.

Nine Months Ended September 30, 2001 Compared to the Nine Months Ended September 30, 2000

Net Sales. Net sales for the nine months ended September 30, 2001 increased by 45% to $173.5 million from $119.8 million in the comparable 2000 period. This increase in net sales was primarily due to the increase in net sales from several new products. Specifically, in November 1999, the Company launched Percocet(R) 2.5/325, Percocet(R) 7.5/500 and Percocet(R) 10.0/650 to complement the existing Percocet(R) 5.0/325 for the relief of moderate-to-severe pain. In September 1999, the Company launched Lidoderm(R), the first FDA-approved product for the treatment of the pain of post-herpetic neuralgia. In November 1998, the Company launched the 15mg, 30mg and 60mg strengths, in May 2001, the Company launched the 100mg strength and in September 2001, the Company launched the 200mg strength of its generic morphine sulfate extended release tablets. In the second quarter of 2001, the Company launched two new strengths of its generic product Endocet(R). In April 2001, generic equivalents to Percocet(R) 7.5/500 and Percocet(R) 10.0/650 became available. These generics may have a material impact on the results of operations and cash flows of the Company in the future.

Gross Profit. Gross profit for the nine months ended September 30, 2001 increased by 56% to $119.2 million from $76.2 million in the comparable 2000 period. Gross profit margins increased to 69% from 64% due to a more favorable mix of higher margin products resulting from the product launches discussed above, and the discontinuation of some lower margin non-core products. In addition, the increase in gross profit margins was also due to the existing fixed cost nature of the Company's manufacturing relationship with Bristol-Myers Squibb Company (formerly DuPont Pharmaceuticals), currently the Company's most significant contract manufacturing relationship. If the Company achieves its forecast for revenue and product mix, the Company's management expects the increase in gross profits to continue.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the nine months ended September 30, 2001 increased by 35% to $54.9 million from $40.7 million in the comparable 2000 period. This increase was due to a $7.1 million increase in sales and promotional efforts in 2001 over the comparable 2000 period to support Lidoderm(R) and Percocet(R). The increase in sales and promotional efforts was primarily due to the first quarter 2001 deployment of a dedicated contract sales force of 230 full-time representatives comprised of 70 full-time specialty representatives and 160 full-time primary care representatives compared to 300 part-time representatives in the comparable 2000 period. In addition, the Company experienced an increase in personnel-related costs in the general and administrative functions in order to support its growth.

Research and Development Expenses. Research and development expenses for the nine months ended September 30, 2001 increased by 59% to $25.4

million from $16.0 million in the comparable 2000 period. This increase was due to the Company's increased spending on products under development that are focused in pain management including the products under development that had been part of the former Algos pipeline. The results of operations of Algos have been included in the Company's financial statements prospectively for reporting periods beginning July 17, 2000.

Depreciation and Amortization. Depreciation and amortization for the nine months ended September 30, 2001 increased to $37.2 million from $15.0 million in the comparable 2000 period. This increase was substantially due to the increase in amortization of goodwill and other intangibles resulting from the intangible assets acquired as a result of the Merger. The results of operations of Algos have been included in the Company's financial statements prospectively for reporting periods beginning July 17, 2000.

Compensation Related to Stock Options. Compensation related to stock options of $37.3 million in the nine months ended September 30, 2001 reflects the charge arising from the vesting of performance-based stock options granted pursuant to the Endo Pharma LLC stock option plans. Under these plans, tranches of options vest when the Company attains certain Common Stock price targets. As each tranche vests, the Company incurs a non-cash charge representing the difference between the market price of the shares of Common Stock underlying the options and the exercise price of such options. The Company may in the future incur up to two additional charges in relation to the Endo Pharma LLC options. These charges may be substantial. These options are exercisable into shares of Common Stock that are presently held by Endo Pharma LLC. As a result, the exercise of these options will not result in the issuance of additional shares of Common Stock and will not dilute the public stockholders of Endo.

Purchased In-Process Research and Development. Purchased in-process research and development for the nine months ended September 30, 2000 of $133.2 million resulted from the estimated fair value of the products under development that the Company acquired in the Merger with Algos.

Merger and Other Related Costs. Merger and other related costs for the nine months ended September 30, 2000 of $1.6 million resulted from fees incurred as a result of the Merger with Algos that were not considered direct costs of the acquisition.

Separation Benefits. Separation benefits of $22.0 million for the nine months ended September 30, 2000 resulted from a $20.8 million charge related to the acceleration of vesting of stock options held by two former executives and a $1.2 million charge from compensation and other benefits pursuant to two separation and release agreements the Company entered into. The stock compensation charge reflects the estimated difference in the fair value and the exercise price of such stock options on the effective date of the separation and release agreements.

Consolidated EBITDA. Consolidated EBITDA for the nine months ended September 30, 2001 increased by 83% to $55.9 million from $30.6 million in the comparable 2000 period.

Interest Expense, Net. Interest expense, net for the nine months ended September 30, 2001 decreased by 20% to $9.1 million from $11.4 million in the comparable 2000 period. The decrease was primarily due to a decrease in interest expense of $1.8 million due to a decrease in interest rates. In addition, the decrease was due to an increase in interest income of $.6 million due to an increase in the average cash balance for the nine months ended September 30, 2001 compared to the comparable 2000 period. The increase in the average cash balance was in part due to the acquisition of $19.6 million in net cash and cash equivalents in the Merger with Algos.

Income Tax (Benefit). Income tax (benefit) for the nine months ended September 30, 2001 decreased as a result of an decrease in the taxable loss and, for the nine months ended September 30, 2001, reflects only state income tax benefit. The Company has recorded a valuation allowance on its existing federal deferred tax assets due to the uncertainty of the utilization of such amounts in the foreseeable future. The Company continually evaluates whether conditions exist that indicate that the utilization of deferred tax assets will be more likely than not.

Liquidity and Capital Resources

Net cash provided by operating activities increased by $47.0 million to $68.0 million for the nine months ended September 30, 2001 from $21.0 million for the nine months ended September 30, 2000. This increase was substantially due to a reduction in cash flow utilized in inventory and other working capital improvements. Specifically, during the nine months ended September 30, 2000, the Company was building up inventories to support the launches of several new products, which utilized a significant amount of cash flow.

Net cash used in investing activities was $4.9 million for the nine months ended September 30, 2001 compared to net cash provided by investing activities of $18.7 million for the nine months ended September 30, 2000. The $19.6 million in net cash acquired from the merger with Algos was offset by an increase in capital expenditures of $4.0 million. This increase in capital expenditures was due to the implementation of an electronic document management system during 2001 and the purchase of leasehold improvements and other furniture and fixtures related to the Company's new principal executive offices, the lease of which commenced in the third quarter of 2001.

Net cash utilized in financing activities increased by $20.1 million to $32.9 million for the nine months ended September 30, 2001 from $12.8 million for the nine months ended September 30, 2000 due to repayments made on the Company's existing credit facility. On October 29, 2001, the Company repaid in full the term loans under its existing credit facility.

On March 15, 2001, Penwest Pharmaceuticals Co., a collaboration partner of Endo with which Endo has an alliance agreement and with which Endo is developing one of its pipeline projects, received a "going concern" opinion from Ernst & Young LLP, its independent auditors, in connection with Penwest's Annual Report on Form 10-K for the year ended December 31, 2000. Specifically, Ernst & Young stated that they had substantial doubt about Penwest's ability to continue as a going concern in light of its recurring operating losses and negative cash flows from operations in each of the three years in the period ended December 31, 2000. In addition, Penwest's Annual Report indicated that, based on anticipated levels of operations and currently available capital resources, Penwest's management expects continued operating losses and negative cash flows during 2001. On July 10, 2001, Penwest announced that it had entered into definitive agreements for the sale of 2.4 million shares of newly issued common stock to selected institutional and other accredited investors for an aggregate of $30.0 million. On July 25, 2001, Penwest filed a Report on Form 8-K with the SEC that contained an opinion of Ernst & Young LLP that, on account of this issuance of $30.0 million of common stock, the conditions that raised substantial doubt about whether Penwest will continue as a going concern no longer exist. In Penwest's quarterly report for the quarter ended June 30, 2001, Penwest stated that its existing capital resources, including, among other things, the proceeds of the private placement of $30.0 million of common stock, will enable Penwest to "maintain currently-planned operations into at least the fourth quarter of 2002." If Penwest is unable to fund

their portion of the collaboration project with Endo, this may adversely affect the Company's results of operations and cash flows in the foreseeable future.

The Company's cash and cash equivalents totaled $89.3 million at September 30, 2001. On October 23, 2001, the Company completed a public offering of 11.4 million primary shares of Common Stock. On October 29, 2001, the Company used the net proceeds of this public offering totaling $84.9 million together with $16.1 million of cash and cash equivalents to repay in full the term loans under its existing credit facility. The Company believes that its (a) cash and cash equivalents and (b) cash flow from operations, will be sufficient to meet its normal operating, investing and financing requirements in the foreseeable future, including the funding of the Company's pipeline projects in the event that Endo's collaboration partners are unable to fund their portion of any particular project. The Company may use a portion of its cash and cash equivalents to repay all or a portion of the notes that it has issued to Bristol-Myers Squibb Company (formerly DuPont Pharmaceuticals), for possible acquisitions and/or for possible repurchase of warrants originally issued to the former stockholders of Algos in connection with the Company's acquisition of Algos. The Company may repurchase these warrants in privately negotiated transactions, open market purchases, tender offers or otherwise. Repurchase of these warrants would be subject to market conditions and receipt of any required third party consents and waivers. In the event that the Company makes any significant acquisitions or other strategic investments, it may be required to raise additional funds, through the issuance of additional debt or equity securities.

The Company is currently negotiating the terms of a new senior secured credit facility with a number of lenders, including affiliates of certain of the underwriters of the recent public offering, to replace the Company's existing credit agreement. The Company currently expects the new credit facility to be in the amount of approximately $100 million and to have a final maturity of five years. Any outstanding loans under the new credit facility may be secured by a first priority security interest in substantially all of the Company's assets. The new credit facility is expected to contain representations and warranties, covenants, events of default and other provisions customarily found in similar agreements. The Company cannot assure you that it will be able to enter into the new credit facility on the terms described above or at all.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities, which is 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 on-going effectiveness assessments in order to use hedge accounting. A derivative that does not qualify as a hedge will be marked to fair value through earnings.

At January 1, 2001, the Company recorded $0.2 million as an accumulated transition adjustment as a reduction to earnings relating to cash flow hedges.

In December 1999, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin, 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 the Company's 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 the Company's financial statements.

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 is 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. Upon adoption, the Company will no longer amortize goodwill unless evidence of an impairment exists. Goodwill will be evaluated for impairment on at least an annual basis. Although the Company is currently evaluating all of the provisions of SFAS No. 141 and SFAS No. 142 and therefore is not presently able to quantify the impact of adoption, the Company does believe the adoption of SFAS No. 142 will have a material impact on the results of operations of the Company. The Company has $228.1 million of goodwill as of September 30, 2001 and has recorded $30.7 million of goodwill amortization for the nine months ended September 30, 2001. The Company will adopt the provisions of SFAS No. 142 effective January 1, 2002.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The Company's primary market risk exposure is to changes in interest rates (LIBOR) on its variable rate borrowings. The Company does not utilize financial instruments for trading purposes and holds no derivative financial instruments that could expose it to significant market risk. The Company monitors interest rates and enters into interest rate agreements as considered appropriate. To manage a portion of its exposure to fluctuations in interest rates, the Company had entered into an interest rate cap agreement with a notional amount of $82.5 million that sets a maximum LIBOR rate of 8% that it will pay on the related notional amount. This interest rate cap agreement expired on August 27, 2000. Effective August 27, 2000, the Company has entered into a new interest rate cap agreement with a notional amount of $70.0 million that sets a maximum LIBOR rate of 8% that the Company will pay on the related notional amount through August 27, 2003. On October 29, 2001, the Company repaid its existing variable rate borrowings, thereby terminating its interest rate cap agreement.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

On October 20, 2000, The Purdue Frederick Company and related companies ("Purdue Frederick") filed suit against the Company and its subsidiary, Endo Pharmaceuticals Inc. ("EPI"), in the U.S. District Court for the Southern District of New York alleging that EPI's bioequivalent version of Purdue Frederick's OxyContin(R) (oxycodone hydrochloride extended-release tablets), 40mg strength, infringes three of its patents. This suit arose after EPI provided the plaintiffs with notice that its ANDA submission for a bioequivalent version of Purdue Frederick's OxyContin(R), 40mg strength, challenged the listed patents for OxyContin(R) 40mg tablets. On March 13, 2001, Purdue Frederick filed a second suit against the Company and EPI in the U.S. District Court for the Southern District of New York alleging that EPI's bioequivalent versions of Purdue Frederick's OxyContin(R), 10mg and 20mg strengths, infringe the same three patents. This suit arose from EPI having amended its earlier ANDA on February 9, 2001 to add bioequivalent versions of the 10mg and 20mg strengths of OxyContin(R). On August 30, 2001, Purdue Frederick filed a third suit against the Company and EPI in the U.S. District Court for the Southern District of New York alleging that EPI's bioequivalent version of Purdue Frederick's OxyContin(R), 80mg strength, infringes the same three patents. This suit arose from EPI having amended its earlier ANDA on July 30, 2001 to add the bioequivalent version of the 80mg strength of OxyContin(R).

For each of the 10mg, 20mg, 40mg and 80mg strengths of this product, EPI made the required Paragraph IV certification against the patents listed in the FDA's Orange Book as covering these strengths of OxyContin(R). EPI has pleaded counterclaims that the patents asserted by Purdue Frederick are invalid, unenforceable and/or not infringed by EPI's formulation of oxycodone hydrochloride extended-release tablets, 10mg, 20mg and 40mg strengths. EPI has also counterclaimed for antitrust damages based on allegations that Purdue Frederick obtained the patents through fraud on the United States Patent and Trademark Office and is asserting them while aware of their invalidity and unenforceability. The Company intends to pursue a similar litigation strategy with respect to the 80mg strength of this product. However, the Company cannot make assurances as to the outcome of this patent challenge. Purdue Frederick was granted a preliminary injunction (Purdue Pharma L.P. v. Boehringer Ingelheim GmbH, 98 F. Supp. 2d 362 (SDNY 2000)), which decision was affirmed on appeal (Purdue Pharma L.P. v. Boehringer Ingelheim GmbH, 237 F.3d 1359 (Fed. Cir. 2001)), against a different manufacturer based on the same patents that are being asserted against the Company and EPI, and in the same Court in which Purdue Frederick sued. The Company believes the defenses rejected in the preliminary injunction decision and in the appellate decision do not substantially impact the principal defenses raised by the Company and EPI.

We expect to be sued again as early as the fourth quarter of 2001 with respect to another ANDA we have filed with the FDA. Similar litigation may also result from products we currently have in development, as well as those which we may develop in the future. We, however, cannot predict the timing or outcome of any such litigation, or whether any such litigation will be brought against us.

In addition to the above, the Company is involved in, or has been involved in, arbitrations or legal proceedings that arise from the normal course of its business. The Company cannot predict the timing or outcome of these claims and proceedings. Currently, the Company is not involved in any arbitration and/or legal proceeding that it expects to have a material effect on its business, financial condition or results of operations and cash flows.

Item 2. Changes in Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

The information called for by this item is incorporated herein by reference to the Exhibit Index of this report.

(b) Reports on Form 8-K.

The Company filed three reports on Form 8-K during the quarter ended September 30, 2001. The dates of these reports (and the items reported) are as follows: August 31, 2001 (Item 5); September 5, 2001 (Item 5); and September 10, 2001 (Items 5 and 9). Item 9 of the September 10, 2001 Form 8-K incorporated the Company's Form S-3 (File No. 333-69136), which was filed with the SEC on September 7, 2001 and included financial statements.

SIGNATURES

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

ENDO PHARMACEUTICALS HOLDINGS INC.
(Registrant)

/s/ CAROL A. AMMON

Name: Carol A. Ammon
Title: President and Chief Executive Officer

/s/ JEFFREY R. BLACK

Name: Jeffrey R. Black
Title: Senior Vice President and Chief Financial Officer

Date: November 14, 2001

Exhibit Index

Exhibit No.	Title
2.1	Amended and Restated Agreement and Plan of Merger, dated as of March 3, 2000 (the "Merger Agreement"), by and among Endo Pharmaceuticals Holdings Inc. ("Endo"), Endo Inc. and Algos Pharmaceutical Corporation ("Algos") (incorporated herein by reference to Exhibit 2.1 of the Registration Statement on Form S-4 of the Registrant (Registration No. 333-39040) (the "Registration Statement"), filed with the Securities and Exchange Commission (the "Commission") on June 9, 2000)
2.2	Amendment, dated as of April 17, 2000, to the Merger Agreement, by and between Endo, Endo Inc. and Algos (incorporated herein by reference to Exhibit 2.2 of the Registration Statement filed with the Commission on June 9, 2000)
2.3	Asset Purchase Agreement, dated as of August 27, 1997, by and between Endo Pharmaceuticals Inc. ("Endo Pharmaceuticals") and The DuPont Merck Pharmaceutical Company ("DuPont Merck Pharmaceutical") (incorporated herein by reference to Exhibit 2.3 of the Registration Statement filed with the Commission on June 9, 2000)
3.1	Amended and Restated Certificate of Incorporation of Endo (incorporated herein by reference to Exhibit 3.1 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
3.2	Amended and Restated By-laws of Endo (incorporated herein by reference to Exhibit 3.2 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
4.1	Amended and Restated Executive Stockholders Agreement, dated as of July 14, 2000, by and among Endo, Endo Pharma LLC ("Endo LLC"), Kelso Investment Associates V, L.P. ("KIA V"), Kelso Equity Partners V, L.P. ("KEP V") and the Management Stockholders (as defined therein) (incorporated herein by reference to Exhibit 4.1 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
4.2	Amended and Restated Employee Stockholders Agreement, dated as of July 14, 2000, by and among Endo, Endo LLC, KIA V, KEP V and the

	Employee Stockholders (as defined therein) (incorporated herein by reference to Exhibit 4.2 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
4.3	Form of Stock Certificate of Endo Common Stock (incorporated herein by reference to Exhibit 4.3 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
4.4	Registration Rights Agreement, dated as of July 17, 2000, by and between Endo and Endo LLC (incorporated herein by reference to Exhibit 4.4 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
10.1	Endo Warrant Agreement, dated as of July 17, 2000, by and between Endo and United States Trust Company of New York (incorporated herein by reference to Exhibit 10.1 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
10.2	Algos Warrant Agreement, dated as of July 17, 2000, by and between Endo and United States Trust Company of New York (incorporated herein by reference to Exhibit 10.2 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
10.3	Form of Series A Warrant to Purchase Shares of Common Stock and Warrants of Endo (incorporated herein by reference to Exhibit 10.3 of the Registration Statement filed with the Commission on June 9, 2000)
10.4	Letter Agreement, dated as of November 26, 1999, by and among Algos, Endo, KIA V and KEP V (incorporated herein by reference to Exhibit 10.4 of the Registration Statement filed with the Commission on June 9, 2000)
10.5	Tax Sharing Agreement, dated as of July 17, 2000, by and among Endo, Endo Inc. and Endo LLC (incorporated herein by reference to Exhibit 10.5 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
10.6	Agreement, dated as of July 17, 2000, by and between Endo and Endo LLC (incorporated herein by reference to Exhibit 10.6 of the Form 10-Q for the Quarter ended June 30, 2000 filed with the Commission on August 15, 2000)
10.7	Credit Agreement, dated as of August 26, 1997, by and between Endo Pharmaceuticals and The Chase Manhattan Bank (incorporated herein by reference to Exhibit 10.7 of the Registration

	Statement filed with the Commission on June 9, 2000)
10.8	[Intentionally Omitted.]
10.9	[Intentionally Omitted.]
10.10	Sole and Exclusive License Agreement, dated as of November 23, 1998, by and between Endo Pharmaceuticals and Hind Health Care, Inc. (incorporated herein by reference to Exhibit 10.10 of the Registration Statement filed with the Commission on June 9, 2000)
10.11	Analgesic License Agreement, dated as of October 27, 1997, by and among Endo Pharmaceuticals, Endo Laboratories, LLC and DuPont Merck Pharmaceutical (incorporated herein by reference to Exhibit 10.11 of the Registration Statement filed with the Commission on June 9, 2000)
10.12	Anti-Epileptic License Agreement, dated as of October 27, 1997, by and among Endo Pharmaceuticals, Endo Laboratories, LLC and DuPont Merck Pharmaceutical (incorporated herein by reference to Exhibit 10.12 of the Registration Statement filed with the Commission on June 9, 2000)
10.13	[Intentionally Omitted.]
10.14	Supply and Manufacturing Agreement, dated as of November 23, 1998, by and between Endo Pharmaceuticals and Teikoku Seiyaku Co., Ltd (incorporated herein by reference to Exhibit 10.14 of the Registration Statement filed with the Commission on June 9, 2000)
10.15	Supply Agreement, dated as of July 1, 1998, by and between Endo Pharmaceuticals and Mallinckrodt Inc. ("Mallinckrodt") (incorporated herein by reference to Exhibit 10.15 of the Registration Statement filed with the Commission on June 9, 2000)
10.16	Supply Agreement for Bulk Narcotics Raw Materials, dated as of July 1, 1998, by and between Endo Pharmaceuticals and Mallinckrodt (incorporated herein by reference to Exhibit 10.16 of the Registration Statement filed with the Commission on June 9, 2000)
10.17	Manufacture and Supply Agreement, dated as of August 26, 1997, by and among Endo Pharmaceuticals, DuPont Merck Pharmaceutical and DuPont Merck Pharma (incorporated herein by reference to Exhibit 10.17 of the Registration Statement filed with the Commission on June 9, 2000)
10.18	Strategic Alliance Agreement, dated as of September 17, 1997, by and between Endo Pharmaceuticals and

	Penwest Pharmaceuticals Group (incorporated herein by reference to Exhibit 10.18 of the Registration Statement filed with the Commission on June 9, 2000)
10.19	Agreement, dated as of February 1, 2000, by and between Endo Pharmaceuticals and Livingston Healthcare Services Inc. (incorporated herein by reference to Exhibit 10.19 of the Registration Statement filed with the Commission on June 9, 2000)
10.20	Medical Affairs Support Services Agreement, dated as of June 1, 1999, by and between Endo Pharmaceuticals and Kunitz and Associates, Inc. (incorporated herein by reference to Exhibit 10.20 of the Registration Statement filed with the Commission on June 9, 2000)
10.21	Endo Pharmaceuticals Holdings Inc. 2000 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.21 of the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2000)
10.22	Endo LLC Amended and Restated 1997 Employee Stock Option Plan (incorporated herein by reference to Exhibit 10.22 of the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2000)
10.23	Endo LLC Amended and Restated 1997 Executive Stock Option Plan (incorporated herein by reference to Exhibit 10.23 of the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2000)
10.24	Endo LLC 2000 Amended and Restated Supplemental Employee Stock Option Plan (incorporated herein by reference to Exhibit 10.24 of the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2000)
10.25	Endo LLC 2000 Amended and Restated Supplemental Executive Stock Option Plan (incorporated herein by reference to Exhibit 10.25 of the Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2000)
10.26	Employment Agreement, dated as of July 17, 2000, by and between Endo and John W. Lyle (incorporated herein by reference to Exhibit 10.26 of the Form 10-Q for the Quarter Ended June 30, 2000)
10.27	Amended and Restated Employment Agreement, dated as of September 1, 2001, by and between Endo Pharmaceuticals and Carol A. Ammon (incorporated herein by reference to Exhibit 10.27 of the Current Report on Form 8-K dated August 31, 2001)
10.28	Amended and Restated Employment Agreement, dated

	as of September 1, 2001, by and between Endo Pharmaceuticals and Jeffrey R. Black (incorporated herein by reference to Exhibit 10.28 of the Current Report on Form 8-K dated August 31, 2001)
10.29	Amended and Restated Employment Agreement, dated as of September 1, 2001, by and between Endo Pharmaceuticals and David Allen Harvey Lee, MD, Ph.D. (incorporated herein by reference to Exhibit 10.29 of the Current Report on Form 8-K dated August 31, 2001)
10.30	Amended and Restated Employment Agreement, dated as September 1, 2001, by and between Endo Pharmaceuticals and Mariann T. MacDonald (incorporated herein by reference to Exhibit 10.30 of the Current Report on Form 8-K dated August 31, 2001)
10.31	Separation and Release Agreement, dated as of March 22, 2000, by and between Endo Pharmaceuticals, Endo and Osagie O. Imasogie (incorporated herein by reference to Exhibit 10.31 of the Registration Statement filed with the Commission on June 9, 2000)
10.32	Separation and Release Agreement, dated as of April 20, 2000, by and between Endo Pharmaceuticals, Endo and Louis J. Vollmer (incorporated herein by reference to Exhibit 10.32 of the Registration Statement filed with the Commission on June 9, 2000)
10.33	Office Lease, dated as of August 26, 1997, by and between Endo Pharmaceuticals and Northstar Development Company (incorporated herein by reference to Exhibit 10.33 of the Registration Statement filed with the Commission on June 9, 2000)
10.34	Lease Agreement, dated as of May 5, 2000, by and between Endo Pharmaceuticals and Painters' Crossing One Associates, L.P. (incorporated herein by reference to Exhibit 10.34 of the Registration Statement filed with the Commission on June 9, 2000)
10.35	Amended and Restated Employment Agreement, dated as of September 1, 2001, by and between Endo and Caroline B. Manogue (incorporated herein by reference to Exhibit 10.35 of the Current Report on Form 8-K dated August 31, 2001)
10.36	Amended and Restated Employment Agreement, dated as of September 1, 2001, by and between Endo and Peter A. Lankau (incorporated herein by reference to Exhibit 10.36 of the Current Report on Form 8-K dated August 31, 2001)
10.37	License Agreement, dated as of August 16, 1993, by and between Endo Inc. (f/k/a Algos

	Pharmaceutical Corporation) and The Medical College of Virginia (incorporated herein by reference to Exhibit 10.4.1 of the registration statement on Form S-1 of Algos Pharmaceutical Corporation declared effective on September 25, 1996)
10.38	[Intentionally Omitted.]
10.39	Master Development and Toll Manufacturing Agreement, dated as of May 3, 2001, by and between Novartis Consumer Health, Inc. and Endo Pharmaceuticals Inc. (incorporated herein by reference to Exhibit 10.39 of the Form 10-Q for the Quarter Ended June 30, 2001)
10.40	[Intentionally Omitted.]
10.41	Service Agreement, dated as of February 1, 2001, by and between Endo Pharmaceuticals Inc. and Ventiv Health U.S. Sales Inc. (incorporated herein by reference to Exhibit 10.41of the Current Report on Form 8-K dated August 31, 2001)
11	Statement Regarding Computation of per Share Earnings

Endo Pharmaceuticals Holdings Inc.
Statement Regarding Computation of Per Share Earnings
(in thousands, except per share data)

	Three Months Ended September 30,		Ni
	2001	2001	200
Numerator:			
Net loss available to common stockholders	$ (32,993)	$ (136,548)	$ (44,
Denominator:			
For basic per share data - weighted average shares	89,139	85,848	89,
Effect of dilutive stock options	-	-	-
For diluted per share data	89,139	85,848	89,

Basic loss per share			
	$ (.37)	$ (1.59)	$ (.50)
Diluted loss per share			
	$ (.37)	$ (1.59)	$ (.50)

e="DISPLAY: inline; FONT-FAMILY: Times New Roman; FONT-SIZE: 10pt">Terms of Restricted Stock Awards. Each restricted share award is evidenced by a restricted stock purchase agreement in such form as the Administrator approves and is subject to the following conditions (as described in further detail in the 2013 Plan):

- Vesting. Shares subject to a restricted share award may become vested over time or upon completion of performance goals set out in advance.

- Purchase Price. Each restricted stock purchase agreement states the purchase price, which may not be less than the minimum lawful amount under applicable state law. Payment of the purchase price, if any, may be made, in the discretion of the Administrator and subject to any legal restrictions, in cash, by check, by delivery of shares of our common stock, by waiver of compensation due or accrued to the participant for services rendered, or any combination of the foregoing methods of payment or any other consideration or method of payment as shall be permitted by the Administrator and applicable corporate law. Without limiting the generality of the foregoing, the Administrator may determine to issue restricted shares as consideration for continued employment or the achievement of specified performance goals or objectives.

- Termination of Service. Restricted share awards shall cease to vest immediately if a participant is terminated for any reason, unless otherwise provided in the applicable restricted stock purchase agreement or unless otherwise determined by the Administrator, and we will generally have the right to repurchase any unvested shares subject thereto for the original purchase price paid by the participant.

- Change of Control. In the event of a change in control of the Company (as defined in the 2013 Plan), restricted share awards will generally be treated in the same manner as options under the 2013 Plan, as described under “Terms of Options”, “Change in Control” above.

- Additional Restrictions. Restricted shares are nontransferable except as specifically provided in the restricted stock purchase agreement and in certain limited circumstances provided in the 2013 Plan.

New Plan Benefits

Future awards to our executive officers and other employees are discretionary. At this time, therefore, the benefits that may be received by our executive officers and other employees if our stockholders approve the 2013 Plan cannot be determined. Because the value of common stock issuable to our non-executive directors under the 2013 Plan will depend on the fair market value of our common stock at future dates, it is not possible to determine exactly the benefits that might be received by our non-executive directors under the 2013 Plan.

Summary of Federal Income Tax Consequences of the 2013 Plan

The following is a brief summary of certain federal income tax consequences of participation in the 2013 Plan. The summary should not be relied upon as being a complete statement of all possible federal income tax consequences. Federal tax laws are complex and subject to change. Participation in the 2013 Plan may also have consequences under state and local tax laws which vary from the federal tax consequences described below. For such reasons, we recommend that each participant consult his or her personal tax advisor to determine the specific tax consequences applicable to him or her.

Incentive Stock Options. No taxable income will be recognized by an optionee under the 2013 Plan upon either the grant or the exercise of an ISO. Instead, a taxable event will occur upon the sale or other disposition of the shares acquired upon exercise of an ISO, and the tax treatment of the gain or loss realized will depend upon how long the shares were held before their sale or disposition. If a sale or other disposition of the shares received upon the exercise of an ISO occurs more than (i) one year after the date of exercise of the option and (ii) two years after the date of grant of the option, the holder will recognize long-term capital gain or loss at the time of sale equal to the full amount of the difference between the proceeds realized and the exercise price paid. However, a sale, exchange, gift or other transfer of legal title of such stock (other than certain transfers upon the optionee's death) before the expiration of either of the one-year or two-year periods described above will constitute a "disqualifying disposition." A disqualifying disposition involving a sale or exchange will result in ordinary income to the optionee in an amount equal to the lesser of (i) the fair market value of the stock on the date of exercise minus the exercise price or (ii) the amount realized on disposition minus the exercise price. If the amount realized in a disqualifying disposition exceeds the fair market value of the stock on the date of exercise, the gain realized in excess of the amount taxed as ordinary income as indicated above will be taxed as capital gain. A disqualifying disposition as a result of a gift will result in ordinary income to the optionee in an amount equal to the difference between the exercise price and the fair market value of the stock on the date of exercise. Any loss realized upon a disqualifying disposition will be treated as a capital loss. Capital gains and losses resulting from disqualifying dispositions will be treated as long-term or short-term depending upon whether the shares were held for more or less than the applicable statutory holding period (which currently is more than one year for long-term capital gains). We will be entitled to a tax deduction in an amount equal to the ordinary income recognized by the optionee as a result of a disposition of the shares received upon exercise of an ISO.

The exercise of an ISO may result in an "adjustment" for purposes of the "alternative minimum tax." Alternative minimum tax is imposed on an individual's income only if the amount of the alternative minimum tax exceeds the individual's regular tax for the year. For purposes of computing alternative minimum tax, the excess of the fair market value on the date of exercise of the shares received on exercise of an ISO over the exercise price paid is included in alternative minimum taxable income in the year the option is exercised. An optionee who is subject to alternative minimum tax in the year of exercise of an ISO may claim as a credit against the optionee's regular tax liability in future years the amount of alternative minimum tax paid which is attributable to the exercise of the ISO. This credit is available in the first year following the year of exercise in which the optionee has regular tax liability.

Non-qualified Stock Options. No taxable income is recognized by an optionee upon the grant of a NQSO. Upon exercise, however, the optionee will recognize ordinary income in the amount by which the fair market value of the shares purchased, on the date of exercise, exceeds the exercise price paid for such shares. The income recognized by the optionee who is an employee will be subject to income tax withholding by the Company out of the optionee's current compensation. If such compensation is insufficient to pay the taxes due, the optionee will be required to make a direct payment to us for the balance of the tax withholding obligation. We will be entitled to a tax deduction equal to the amount of ordinary income recognized by the optionee, provided that certain reporting requirements are satisfied. If the exercise price of a NQSO is paid by the optionee in cash, the tax basis of the shares acquired will be equal to the cash paid plus the amount of income recognized by the optionee as a result of such exercise. If the exercise price is paid by delivering shares of our common stock already owned by the optionee or by a combination of cash and

already-owned shares, there will be no current taxable gain or loss recognized by the optionee on the already-owned shares exchanged (however, the optionee will nevertheless recognize ordinary income to the extent that the fair market value of the shares purchased on the date of exercise exceeds the price paid, as described above). The new shares received by the optionee, up to the number of the old shares exchanged, will have the same tax basis and holding period as the optionee's basis and holding period in the old shares. The balance of the new shares received will have a tax basis equal to any cash paid by the optionee plus the amount of income recognized by the optionee as a result of such exercise, and will have a holding period commencing with the date of exercise. Upon the sale or disposition of shares acquired pursuant to the exercise of a NQSO, the difference between the proceeds realized and the optionee's basis in the shares will be a capital gain or loss and will be treated as long-term capital gain or loss if the shares have been held for more than the applicable statutory holding period (which is currently more than one year for long-term capital gains).

Restricted Shares. If no Section 83(b) election is made and repurchase rights are retained by the Company, a taxable event will occur on each date the participant's ownership rights vest (e.g., when our repurchase rights expire) as to the number of shares that vest on that date, and the holding period for capital gain purposes will not commence until the date the shares vest. The participant will recognize ordinary income on each date shares vest in an amount equal to the excess of the fair market value of such shares on that date over the amount paid for such shares. Any income recognized by a participant who is an employee will be subject to income tax withholding by us out of the participant's current compensation. If such compensation is insufficient to cover the amount to be withheld, the participant will be required to make a direct payment to us for the balance of the tax withholding obligation. We are entitled to a tax deduction in an amount equal to the ordinary income recognized by the participant. The participant's basis in the shares will be equal to the purchase price, if any, increased by the amount of ordinary income recognized.

If a Section 83(b) election is made within 30 days after the date of transfer, or if no repurchase rights are retained by us, then the participant will recognize ordinary income on the date of purchase in an amount equal to the excess of the fair market value of such shares on the date of purchase over the purchase price paid for such shares.

Tax Withholding. Under the 2013 Plan, we have the power to withhold, or require a participant to remit to us, an amount sufficient to satisfy federal, state, local or foreign withholding tax requirements with respect to any options exercised or restricted shares granted under the 2013 Plan. To the extent permissible under applicable tax, securities, and other laws, the Administrator may, in its sole discretion, permit a participant to satisfy an obligation to pay any tax to any governmental entity in respect of any option or restricted shares up to an amount determined on the basis of the lowest marginal tax rate applicable to such participant, in whole or in part, by (i) directing us to apply shares of common stock to which the participant is entitled as a result of the exercise of an option or as a result of the lapse of restrictions on restricted shares, or (ii) delivering to us shares of common stock owned by the participant.

Vote Required

Approval of the 2013 Plan will require the affirmative vote of a majority of the votes properly cast upon the proposal at the Annual Meeting.

Recommendation

The Board recommends that stockholders vote FOR approval of the 2013 Plan.

Unless marked otherwise, proxies received will be voted FOR Proposal No. 4.

PROPOSAL NO. 5 – RATIFICATION OF APPOINTMENT OF PETERSON SULLIVAN LLP

Overview

The Audit Committee has engaged the independent registered public accounting firm of Peterson Sullivan LLP as our independent registered public accounting firm to audit our financial statements for the year ending December 31, 2013. Peterson Sullivan LLP audited our financial statements for the years ended December 31, 2012 and December 31, 2011. Please refer to "Principal Accountants" above for information about fees and services paid to Peterson Sullivan LLP in 2012 and 2011, and our Audit Committee's pre-approval policies. Stockholder ratification of such selection is not required by our Bylaws or other applicable legal requirement. However, our Board is submitting the selection of Peterson Sullivan LLP to stockholders for ratification as a matter of good corporate practice. In the event that stockholders fail to ratify the selection, our Audit Committee will reconsider whether or not to retain that firm. Even if the selection is ratified, our Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if our Audit Committee believes that such a change would be in our and our stockholders' best interests.

Representatives of Peterson Sullivan LLP are expected to be present at the Annual Meeting, will have the opportunity to make a statement if they desire to do so and are expected to be available to respond to appropriate questions.

Vote Sought

The proposal to ratify the appointment of Peterson Sullivan LLP as our independent registered public accounting firm to audit our financial statements for the year ending December 31, 2013 will be approved if approved by a majority of the votes properly cast on this proposal.

Recommendation

The Board recommends that stockholders vote "FOR" the proposal to ratify the appointment of Peterson Sullivan LLP as our independent registered public accounting firm to audit our financial statements for the year ending December 31, 2013.

Unless marked otherwise, proxies received will be voted FOR Proposal No. 5.

OTHER BUSINESS

We know of no other matters to be submitted to the stockholders at the Annual Meeting. If any other matters properly come before the stockholders at the Annual Meeting, the persons named on the enclosed proxy card intend to vote the shares they represent as the Board may recommend.

ANNUAL REPORT ON FORM 10-K

On March 29, 2013, we filed our annual report on Form 10-K for the year ended December 31, 2012. We have sent to our stockholders the Notice of Internet Availability of Proxy Materials containing instructions on how to access via the Internet our 2013 proxy statement and annual report on Form 10-K for 2012. Stockholders who received a paper copy of our 2013 proxy statement were also sent a copy of our annual report on Form 10-K for 2012. Stockholders who wish to obtain additional copies of our annual report on Form 10-K may do so without charge by contacting us through one of the following methods:

Email:	proxy@biolifesolutions.com
Telephone:	(425) 402-1400
Facsimile:	(425) 402-1433
Mail:	Corporate Secretary, BioLife Solutions, Inc. 3303 Monte Villa Parkway, Suite 310 Bothell, Washington 98021

STOCKHOLDER PROPOSALS

Stockholders may present proposals for action at a future meeting if they comply with SEC rules, state law and our Bylaws.

Pursuant to Rule 14a-8 under the Exchange Act, some stockholder proposals may be eligible for inclusion in the proxy statement for our 2014 Annual Meeting of Stockholders (the “2014 Annual Meeting”). These stockholder proposals, along with proof of ownership of our stock in accordance with Rule 14a-8(b)(2), must be received by us not later than January 6, 2014, which is 120 calendar days prior to the anniversary date of the mailing of this proxy statement. Stockholders are also advised to review our Bylaws which contain additional advance notice requirements, including requirements with respect to advance notice of stockholder proposals (other than non-binding proposals presented under Rule 14a-8) and director nominations.

The proxies to be solicited by us through our Board for our 2014 Annual Meeting will confer discretionary authority on the proxy holders to vote on any stockholder proposal presented at that meeting, unless we receive notice of such stockholder’s proposal not later than March 22, 2014, which is 45 calendar days prior to the anniversary date of the mailing of this proxy statement.

Stockholder proposals must be in writing and should be addressed to c/o BioLife Solutions, Inc., Attention: Corporate Secretary, 3303 Monte Villa Parkway, Suite 310, Bothell, Washington 98021. It is recommended that stockholders submitting proposals direct them to our corporate secretary and utilize certified mail, return receipt requested in order to provide proof of timely receipt. The Chairman of the Annual Meeting reserves the right to reject, rule out of order or take other appropriate action with respect to any proposal that does not comply with these and other applicable requirements, including conditions set forth in our Bylaws and conditions established by the SEC.

We have not been notified by any stockholder of his or her intent to present a stockholder proposal from the floor at this year’s Annual Meeting. The enclosed proxy grants the proxy holders discretionary authority to vote on any matter

properly brought before this year's Annual Meeting.

BY ORDER OF THE BOARD OF DIRECTORS

Michael Rice
President, Chief Executive Officer and Chairman

April 30, 2013
Bothell, Washington

Appendix A – 2013 Performance Incentive Plan

BIOLIFE SOLUTIONS, INC.

2013 PERFORMANCE INCENTIVE PLAN

This 2013 PERFORMANCE INCENTIVE PLAN (the "Plan") established by BioLife Solutions, Inc., a Delaware corporation (the "Company"), adopted by its Board of Directors on April 25, 2013 (the "Effective Date") and approved by the Company's stockholders on [INSERT], 2013 (the "Approved Date").

ARTICLE 1

PURPOSES OF THE PLAN

1.1 Purposes. The purposes of the Plan are (a) to enhance the ability of the Company and its Affiliated Companies to attract and retain the services of officers, qualified employees, directors and outside consultants and service providers to the Company, upon whose judgment, initiative and efforts the successful conduct and development of the Company's businesses largely depends, and (b) to provide additional incentives to such persons to devote their utmost effort and skill to the advancement and betterment of the Company, by providing them an opportunity to participate in the ownership of the Company and thereby have an interest in the success and increased value of the Company that coincides with the financial interests of the Company's stockholders.

ARTICLE 2

DEFINITIONS

For purposes of this Plan, in addition to other capitalized terms defined herein, the following terms shall have the meanings indicated:

2.1 Administrator. "Administrator" means the Board, subject to the Board's authority to delegate responsibility for any matter to the Committee or to the Chief Executive Officer of the Company as set forth in Section 7.1 of the Plan.

2.2 Affiliated Company. "Affiliated Company" means any "parent corporation" or "subsidiary corporation" of the Company, whether now existing or hereafter created or acquired, as those terms are defined in Sections 424(e) and 424(f) of the Code, respectively.

2.3 Award. "Award" means an Option or Restricted Share issued to a Participant under the Plan.

2.4 Award Agreement. "Award Agreement" means an Option Agreement or Stock Purchase Agreement issued to a Participant pursuant to the Plan.

2.5 Board. "Board" means the Board of Directors of the Company.

2.6 Cause. "Cause" means, with respect to the termination of a Participant's employment, termination of such employment by the Company for any of the following reasons:

(a) The continued refusal or omission by the Participant to perform any material duties required of him by the Company if such duties are consistent with duties customary for the position held with the Company;

(b) Any material act or omission by the Participant involving malfeasance or gross negligence in the performance of Participant's duties to, or material deviation from any of the policies or directives of, the Company;

(c) Conduct on the part of Participant which constitutes the breach of any statutory or common law duty of loyalty to the Company; or

(d) Any illegal act by Participant which materially and adversely affects the business of the Company or any felony committed by Participant, as evidenced by conviction thereof, provided that the Company may suspend Participant with pay while any allegation of such illegal or felonious act is investigated.

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

(a) The acquisition, directly or indirectly, in one transaction or a series of related transactions, by any person or group (within the meaning of Section 13(d)(3) of the Exchange Act) of the beneficial ownership of securities of the Company possessing more than fifty percent (50%) of the total combined voting power of all outstanding securities of the Company;

(b) A merger or consolidation of the Company with any other entity, whether or not the Company is the surviving entity in such transaction, except for a transaction in which the holders of the outstanding voting securities of the Company immediately prior to such merger or consolidation hold as a result of holding Company securities prior to such transaction, in the aggregate, securities possessing more than fifty percent (50%) of the total combined voting power of all outstanding voting securities of the Company or of the surviving entity (or the parent of the surviving entity) immediately after such merger or consolidation;

(c) The sale, transfer or other disposition (in one transaction or a series of related transactions) of all or substantially all of the assets of the Company; or

(d) The approval by the stockholders of a plan or proposal for the liquidation or dissolution of the Company.

2.8 Code. "Code" means the Internal Revenue Code of 1986, as amended from time to time.

2.9 Committee. "Committee" means a committee of two or more members of the Board appointed to administer the Plan, as set forth in Section 7.1 hereof.

2.10 Common Stock. "Common Stock" means the Common Stock of the Company, $0.001 par value, subject to adjustment pursuant to Section 4.2 hereof.

2.11 Consultant. "Consultant" means any consultant or advisor if: (i) the consultant or advisor renders bona fide services to the Company or any Affiliated Company; (ii) the services rendered by the consultant or advisor are not in connection with the offer or sale of securities in a capital-raising transaction and do not directly or indirectly promote or maintain a market for the Company's securities; and (iii) the consultant or advisor is a natural person who has contracted directly with the Company or any Affiliated Company to render such services.

2.12 Disability. "Disability" means permanent and total disability as defined in Section 22(e)(3) of the Code. The Administrator's determination of a Disability or the absence thereof shall be conclusive and binding on all interested parties.

2.13 DRO. "DRO" means a domestic relations order as defined in the Code or Title I of the Employee Retirement Income Security Act of 1974, as amended, or the regulations thereunder.

2.14 Employee. "Employee" means any officer or other employee (as defined in accordance with Section 3401(c) of the Code) of the Company, or any Affiliated Company.

2.15 Effective Date. "Effective Date" means the date on which the Plan is adopted by the Board, as set forth on the first page hereof.

2.16 Exchange Act. "Exchange Act" means the Securities and Exchange Act of 1934, as amended.

2.17 Exercise Price. "Exercise Price" means the purchase price per share of Common Stock payable upon exercise of an Option.

2.18 Fair Market Value. "Fair Market Value" on any given date means the value of one share of Common Stock, determined as follows:

(a) If the Common Stock is then listed or admitted to trading on a Nasdaq market system or a stock exchange which reports closing sale prices, the Fair Market Value shall be the closing sale price on the date of valuation on such Nasdaq market system or principal stock exchange on which the Common Stock is then listed or admitted to trading, or, if no closing sale price is reported on such day, then the Fair Market Value shall be the closing sale price of the Common Stock on such Nasdaq market system or such exchange on the next preceding day for which a closing sale price is reported.

(b) If the Common Stock is not then listed or admitted to trading on a Nasdaq market system or a stock exchange which reports closing sale prices, the Fair Market Value shall be the average of the closing bid and asked prices of the Common Stock in the over-the-counter market on the date of valuation.

(c) If neither clause (a) nor (b) of this Section 2.18 is applicable as of the date of valuation, then the Fair Market Value shall be determined by the Administrator in good faith using any reasonable method of valuation, which determination shall be conclusive and binding on all interested parties.

2.19 FINRA Dealer. "FINRA Dealer" means a broker-dealer that is a member of the Financial Industry Regulatory Authority, Inc.

2.20 Incentive Option. "Incentive Option" means any Option so designated by the Administrator and intended to qualify as an "incentive stock option" as defined in Section 422 of the Code.

2.21 Incentive Option Agreement. "Incentive Option Agreement" means an Option Agreement with respect to an Incentive Option.

2.22 Nonqualified Option. "Nonqualified Option" means any Option that is not an Incentive Option. To the extent that any Option designated as an Incentive Option fails in whole or in part to qualify as an Incentive Option, including, without limitation, for failure to meet the limitations applicable to a 10% Stockholder or because it exceeds the annual limit provided for in Section 5.6 below, it shall to that extent constitute a Nonqualified Option.

2.23 Nonqualified Option Agreement. "Nonqualified Option Agreement" means an Option Agreement with respect to a Nonqualified Option.

2.24 Option. "Option" means any option to purchase Common Stock granted pursuant to the Plan.

2.25 Option Agreement. "Option Agreement" means the written agreement entered into between the Company and the Optionee with respect to an Option granted under the Plan.

2.26 Optionee. "Optionee" means a Participant who holds an Option.

2.27 Participant. "Participant" means an individual or entity that holds an Award under the Plan.

2.28 Purchase Price. "Purchase Price" means the purchase price per Restricted Share.

2.29 Restricted Shares. "Restricted Shares" means shares of Common Stock issued pursuant to Article 6 hereof, subject to any restrictions and conditions as are established pursuant to such Article 6.

2.30 Rule 16b-3 Covered Person. "Rule 16b-3 Covered Person" means any key Employee or member of the Board designated by the Administrator with respect to which any transaction involving Common Stock may be eligible for the exemption from Section 16(b) of the Exchange Act set forth in Rule 16b-3.

2.31 Section 162(m) Covered Employee. "Section 162(m) Covered Employee" means (i) an employee of the Company if, as of the close of the taxable year, such employee is the Principal Executive Officer of the Company (or an individual acting in such a capacity) and the three (3) officers of the Company (other than the Principal Financial Officer and the Principal Executive Officer) for whom total compensation is required to be reported to stockholders under the Exchange Act by reason of such individuals being among the three (3) highest compensated officers for the relevant taxable year and (ii) any other key Employee designated by the Administrator as a key Employee whose compensation for the fiscal year in which the key Employee is so designated or a future fiscal year may be subject to the limit on deductible compensation imposed by Section 162(m) of the Code.

2.32 Service Provider. "Service Provider" means a Consultant, Employee, member of the Board or other natural person the Administrator authorizes to become a Participant in the Plan and who provides services to (i) the Company, (ii) an Affiliated Company, or (iii) any other business venture designated by the Administrator in which the Company (or any entity that is a successor to the Company) or an Affiliated Company has a significant ownership interest.

2.33 Stock Purchase Agreement. "Stock Purchase Agreement" means the written agreement entered into between the Company and a Participant with respect to the purchase of Restricted Shares under the Plan.

2.34 10% Stockholder. "10% Stockholder" means a person who, as of a relevant date, owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code) stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or of an Affiliated Company.

ARTICLE 3

ELIGIBILITY

3.1 Incentive Options. Only Employees of the Company or of an Affiliated Company (including officers of the Company and members of the Board if they are Employees of the Company or of an Affiliated Company) are eligible to receive Incentive Options under the Plan.

3.2 Nonqualified Options and Restricted Shares. Employees of the Company or of an Affiliated Company, officers of the Company and members of the Board (whether or not employed by the Company or an Affiliated Company), and Service Providers are eligible to receive Nonqualified Options or acquire Restricted Shares.

3.3 Section 162(m) Limitation for Options. The aggregate number of shares of Common Stock with respect to which Options may be granted to any Employee shall not exceed 450,000 shares of Common Stock during any calendar year. Notwithstanding the foregoing, in connection with his or her initial service to the Company, the aggregate number of shares of Common Stock with respect to which Options may be granted to any Employee shall not exceed 450,000 shares of Common Stock during the calendar year which includes such individual's initial service to the Company. Any shares subject to an Option granted during a calendar year to an Employee that can no longer under any circumstances be exercised or purchased for any reason under the Plan shall continue to count against the applicable limitations set forth above for such Employee during such calendar year.

ARTICLE 4

GRANTING OF AWARDS

4.1 Shares Subject to the Plan. The shares of stock available as a basis for Awards shall be Common Stock. Such shares may be issued from either previously authorized but unissued shares or treasury shares, subject to adjustment as to the number and kind of shares pursuant to Section 4.2 hereof. Subject to the foregoing, a total of 2,000,000 shares of Common Stock may be issued under the Plan. Notwithstanding the limitation described in the preceding sentence, if an option granted pursuant to an equity compensation plan of the Company other than the Plan is outstanding as of the Approved Date and such option subsequently terminates or expires in accordance with its terms, the shares of Common Stock underlying such option which remain unexercised and unissued at the time of such termination or expiration, shall become available for grant or issuance under the Plan, subject to adjustment pursuant to Section 4.2 hereof, provided, however, that in no event will there be available greater than 2,000,000 shares of Common Stock for purposes of the issuance of Incentive Options under the Plan, subject to adjustment pursuant to Section 4.2 hereof.

(a) Cancelled or Forfeited Awards other than Restricted Shares. For purposes of the limitation set forth in this Section 4.1, if all or any portion of any Award, other than Restricted Shares, granted or offered under the Plan can no longer under any circumstances be exercised or purchased due to the forfeiture or cancellation of all or any portion of such Award, then the shares of Common Stock allocable to such unexercised or forfeited portions of such Award shall not count against such limitation and shall again become available for grant or issuance under the Plan.

(b) Non-Replenishment of Reacquired Shares; Awards other than Restricted Shares for Reasons other than Cancellation or Forfeiture of Award. For purposes of the limitation set forth in this Section 4.1, any shares of Common Stock subject to an Award, other than Restricted Shares, and which are reacquired by the Company for any reason other than the cancellation or forfeiture of such Award as described in Section 4.1(a) shall count against such limitation. The Company shall hold all such shares of Common Stock that it reacquires as treasury shares, which shall not again become available for grant or issuance under the Plan.

(c) Replenishment of Reacquired Shares; Awards of Restricted Shares. For purposes of the limitation set forth in this Section 4.1, any shares of Common Stock that were initially the subject of a Stock Purchase Agreement, and which are reacquired by the Company for any reason, shall not count against such limitation and shall again become available for grant or issuance under the Plan.

4.2 Changes in Capital Structure. In the event that the outstanding shares of Common Stock are hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company by reason of a recapitalization, stock split, reverse stock split, combination of shares, reclassification, stock dividend, or other similar change in the capital structure of the Company, then appropriate adjustments shall be made by the Administrator to the aggregate number and kind of shares issuable thereafter under this Plan, the number and kind of shares and the price per share subject to outstanding Award Agreements and the limit on the number of shares under Sections 3.3 and 3.4 above, all in order to preserve, as nearly as practical, but not to increase, the benefits to Participants.

4.3 Award Agreement. Each Award shall be evidenced by an Award Agreement. Award Agreements evidencing Incentive Options shall contain such terms and conditions as may be necessary to meet the applicable provisions of Section 422 of the Code.

4.4 Rule 16b-3 Covered Persons. Notwithstanding any other provision of the Plan, the Plan and any Award granted or awarded to a Rule 16b-3 Covered Person shall be subject to any additional limitations set forth in any applicable exemptive rule under Section 16 of the Exchange Act (including Rule 16b-3 under the Exchange Act) that are requirements for the application of such exemptive rule. To the extent permitted by applicable law, the Plan and Awards granted or awarded hereunder shall be deemed amended to the extent necessary to conform to such applicable exemptive rule(s).

ARTICLE 5

OPTIONS

5.1 Option Agreement. Each Option granted pursuant to this Plan shall be evidenced by an Option Agreement that shall specify the number of shares subject thereto, the Exercise Price per share, and whether the Option is an Incentive Option or Nonqualified Option. As soon as is practical following the grant of an Option, an Option Agreement shall be duly executed and delivered by or on behalf of the Company to the Optionee to whom such Option was granted. Each Option Agreement shall be in such form and contain such additional terms and conditions, not inconsistent with the provisions of this Plan, as the Administrator shall, from time to time, deem desirable, including, without limitation, the imposition of any rights of first refusal and resale obligations upon any shares of Common Stock acquired pursuant to an Option Agreement. Each Option Agreement may be different from each other Option Agreement.

5.2 Exercise Price. The Exercise Price per share of Common Stock covered by each Option shall be determined by the Administrator, subject to the following: (a) the Exercise Price of an Option shall not be less than 100% of Fair Market Value on the date the Option is granted and (b) if the person to whom an Incentive Option is granted is a 10% Stockholder on the date of grant, the Exercise Price shall not be less than 110% of Fair Market Value on the date the Option is granted. However, an Incentive Option may be granted with an Exercise Price lower than that set forth in clause (b) of the preceding sentence if such Incentive Option is granted pursuant to an assumption or substitution for another option in a manner satisfying the provisions of Section 424 of the Code.

5.3 Payment of Exercise Price. Payment of the Exercise Price shall be made upon exercise of an Option and may be made, in the discretion of the Administrator, subject to any legal restrictions, by: (a) cash; (b) check; (c) the surrender of shares of Common Stock acquired pursuant to the exercise of an Option (provided that shares acquired pursuant to the exercise of Options must have been held by the Optionee for the requisite period necessary to avoid a charge to the Company's earnings for financial reporting purposes), which surrendered shares shall be valued at Fair Market Value as of the date of such exercise; (d) the waiver of compensation due or accrued to the Optionee for services rendered; (e) a "same day sale" commitment from the Optionee and a FINRA Dealer whereby the Optionee irrevocably elects to exercise the Option and to sell a portion of the shares so purchased to pay for the Exercise Price and whereby the FINRA Dealer irrevocably commits upon receipt of such shares to forward the Exercise Price directly to the Company; or (f) any combination of the foregoing methods of payment or any other consideration or method of payment as shall be permitted by applicable law, including the Sarbanes-Oxley Act of 2002, as amended. Any shares of Common Stock received by the Company in payment of the Exercise Price shall be held by the Company as treasury shares and shall not be made available for grant or issuance under the Plan.

5.4 Term and Termination of Options. The term and provisions for termination of each Option shall be as fixed by the Administrator, but no Option may be exercisable more than ten (10) years after the date it is granted. An Incentive Option granted to a person who is a 10% Stockholder on the date of grant shall not be exercisable more than five (5) years after the date it is granted.

5.5 Vesting and Exercise of Options. Each Option shall vest and become exercisable in one or more installments at such time or times and subject to such conditions, including without limitation the achievement of specified performance goal(s) or objectives, as shall be determined by the Administrator.

5.6 Annual Limit on Incentive Options. To the extent required for "incentive stock option" treatment under Section 422 of the Code, the aggregate Fair Market Value (determined as of the time of grant) of the Common Stock, with respect to which Incentive Options granted under this Plan and any other plan of the Company or any Affiliated Company become exercisable for the first time by an Optionee during any calendar year, shall not exceed $100,000.

5.7 Nontransferability of Options. Except as otherwise provided by the Administrator in an Option Agreement and as permissible under applicable law, no Option shall be assignable or transferable except by will or the laws of descent and distribution, and during the life of the Optionee shall be exercisable only by such Optionee unless it has been disposed of with the consent of the Administrator (which consent may be withheld in the Administrator's sole and absolute discretion) pursuant to a DRO. Notwithstanding the foregoing, no Option shall be assignable or transferable in exchange for consideration.

5.8 Rights as Stockholder. An Optionee or permitted transferee of an Option shall have no rights or privileges as a stockholder with respect to any shares covered by an Option until such Option has been duly exercised and certificates representing shares purchased upon such exercise have been issued to such person.

ARTICLE 6

RESTRICTED SHARES

6.1 Issuance and Sale of Restricted Shares. The Administrator shall have the right to grant Restricted Shares subject to such terms, restrictions and conditions as the Administrator may determine at the time of grant ("Restricted Share Awards"). Such conditions shall include the Purchase Price to be paid by the grantee for such an Award, if any (but not less than the minimum lawful amount under applicable state law). Such conditions may also include, but are not limited to, continued employment or the achievement of specified performance goal(s) or objectives.

6.2 Stock Purchase Agreements. A Participant shall have no rights with respect to the Restricted Shares covered by a Stock Purchase Agreement until the Participant has paid the full Purchase Price (if applicable) to the Company in the manner set forth in Section 6.3 hereof and has executed and delivered to the Company the Stock Purchase Agreement. Each Stock Purchase Agreement shall be in such form, and shall set forth the Purchase Price and such other terms, conditions and restrictions of the Restricted Shares, not inconsistent with the provisions of this Plan, as the Administrator shall, from time to time, deem desirable. Each Stock Purchase Agreement may be different from each other Stock Purchase Agreement.

6.3 Payment of Purchase Price. Subject to any legal restrictions, payment of the Purchase Price, if any, may be made, in the discretion of the Administrator, by: (a) cash; (b) check; (c) the surrender of shares of Common Stock owned by the Participant that have been held by the Participant for the requisite period necessary to avoid a charge to the Company's earnings for financial reporting purposes, which surrendered shares shall be valued at Fair Market Value as of the date of such acceptance; (d) the waiver of compensation due or accrued to the Participant for services rendered; or (e) any combination of the foregoing methods of payment or any other consideration or method of payment as shall be permitted by applicable corporate law, including the Sarbanes-Oxley Act of 2002, as amended.

6.4 Rights as a Stockholder. Upon complying with the provisions of Section 6.2 hereof, a Participant shall have the rights of a stockholder with respect to the Restricted Shares purchased pursuant to a Stock Purchase Agreement, including voting and dividend rights, subject to the terms, restrictions and conditions as are set forth in such Stock Purchase Agreement. Unless the Administrator shall determine otherwise, certificates evidencing Restricted Shares shall remain in the possession of the Company until such shares have vested in accordance with the terms of the Stock Purchase Agreement.

6.5 Restrictions. Restricted Shares may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of except as specifically provided in the Stock Purchase Agreement. In the event of termination of a Participant's employment, service as a director of the Company or Service Provider status for any reason whatsoever (including death or disability), the Stock Purchase Agreement may provide, in the discretion of the Administrator, that the Company shall have the right, exercisable at the discretion of the Administrator, to repurchase, at the original Purchase Price, any Restricted Shares which have not vested as of the date of termination. Notwithstanding the foregoing, Restricted Share Awards may be transferred, with the consent of the Administrator, pursuant to a DRO (which consent may be withheld in the Administrator's sole and absolute discretion).

6.6 Vesting of Restricted Shares. Subject to Section 6.5 above, the Stock Purchase Agreement shall specify the date or dates, the performance goal(s) or objectives that must be achieved, and any other conditions on which the Restricted Shares may vest.

ARTICLE 7

ADMINISTRATION OF THE PLAN

7.1 Administrator. Authority to control and manage the operation and administration of the Plan shall be vested in the Board, which may delegate such responsibilities in whole or in part to one or more Committees. Members of the Committee may be appointed from time to time by, and shall serve at the pleasure of, the Board. Without limiting the foregoing, the Board may limit the composition of the Committee to those persons necessary to comply with the requirements of Section 162(m) of the Code and the regulations promulgated thereunder, and Section 16 of the Exchange Act and Rule 16b-3 under the Exchange Act. The Board (or the Committee, as applicable) may delegate to the Chief Executive Officer of the Company the authority to (i) designate new Employees who are not officers of the Company to be the recipient of Incentive Options, Nonqualified Options or Restricted Shares, and (ii) determine the number of shares of Common Stock to be subject to such Incentive Options, Nonqualified Options or Restricted Shares; provided, however, that the Board resolutions regarding such delegation of authority or an employee compensation program approved by the Board or Committee shall specify the maximum number of shares of Common Stock that may be subject to any Incentive Option, Nonqualified Option or Restricted Shares granted by the Chief Executive Officer depending upon the employee group of such new Employee; and provided, further, that the Chief Executive Officer may not grant Options to himself, or any other officer of the Company. As used herein, the term "Administrator" means the Board or, with respect to any matter as to which responsibility has been delegated to the Committee or the Chief Executive Officer, the term Administrator shall mean the Committee or the Chief Executive Officer, as the case may be.

7.2 Powers of the Administrator. In addition to any other powers or authority conferred upon the Administrator elsewhere in the Plan or by law, the Administrator shall have full power and authority: (a) to determine the persons to whom, and the time or times at which, Awards shall be granted, the number of shares to be represented by each Option, the number of Restricted Shares to be offered, and the consideration to be received by the Company upon the exercise of or sale of such Awards; (b) to interpret the Plan; (c) to create, amend or rescind rules and regulations relating to the Plan; (d) to determine the terms, conditions and restrictions contained in, and the form of, Award Agreements; (e) to determine the identity or capacity of any persons who may be entitled to exercise a Participant's rights under any Award Agreement under the Plan; (f) to correct any defect or supply any omission or reconcile any inconsistency in the Plan or in any Award Agreement; (g) to accelerate the vesting of any Award or release or waive any repurchase rights of the Company with respect to any Award; (h) to extend the exercise date of any Award or acceptance date of any Award; (i) to provide for rights of first refusal and/or repurchase rights; (j) to amend outstanding Award Agreements to provide for, among other things, any change or modification which the Administrator could have included in the original Award Agreement or in furtherance of the powers provided for herein; and (k) to make all other determinations necessary or advisable for the administration of the Plan, but only to the extent not contrary to the express provisions of the Plan. Any action, decision, interpretation or determination made in good faith by the Administrator in the exercise of its authority conferred upon it under the Plan shall be final and binding on the Company and all Participants. In making any determination or in taking or not taking any action under the Plan, the Administrator may obtain and rely upon the advice of experts, including advisors to the Company.

7.3 Limitation on Liability. No Employee of the Company or member of the Board or Committee shall be subject to any liability with respect to duties under the Plan unless the person acts fraudulently or in bad faith. To the extent permitted by law, the Company shall indemnify each member of the Board or Committee, and any Employee of the Company with duties under the Plan, who was or is a party, or is threatened to be made a party, to any threatened, pending or completed proceeding, whether civil, criminal, administrative or investigative, by reason of such person's conduct in the performance of duties under the Plan.

ARTICLE 8

CHANGE IN CONTROL

8.1 Change in Control. In order to preserve a Participant's rights in the event of a Change in Control of the Company:

(a) The Administrator shall have the discretion to provide in each Award Agreement the terms and conditions that relate to (i) vesting of such Award in the event of a Change in Control, and (ii) assumption of such Awards or issuance of comparable securities under an incentive program in the event of a Change in Control. The aforementioned terms and conditions may vary in each Award Agreement.

(b) If the terms of an outstanding Option Agreement provide for accelerated vesting in the event of a Change in Control, or to the extent that an Option is vested and not yet exercised, the Administrator in its discretion may provide, in connection with the Change in Control transaction, for the purchase or exchange of each Option for an amount of cash or other property having a value equal to the difference (or "spread") between: (x) the value of the cash or other property that the Participant would have received pursuant to the Change in Control transaction in exchange for the shares issuable upon exercise of the Option had the Option been exercised immediately prior to the Change in Control, and (y) the Exercise Price of the Option.

(c) Outstanding Options shall terminate and cease to be exercisable upon consummation of a Change in Control except to the extent that the Options are assumed by the successor entity (or parent thereof) pursuant to the terms of the Change in Control transaction.

(d) The Administrator shall cause written notice of a proposed Change in Control transaction to be given to Participants not less than fifteen (15) days prior to the anticipated effective date of the proposed transaction.

ARTICLE 9

AMENDMENT AND TERMINATION OF THE PLAN

9.1 Amendments. Subject to applicable law, including Nasdaq stockholder approval requirements, the Board may from time to time alter, amend, suspend or terminate the Plan in such respects as the Board may deem advisable. No such alteration, amendment, suspension or termination shall be made which shall substantially affect or impair the rights of any Participant under an outstanding Award Agreement without such Participant's consent. The Board may alter or amend the Plan to comply with requirements under the Code relating to Incentive Options or other types of options which give Optionees more favorable tax treatment than that applicable to Options granted under this Plan as of the date of its adoption. Upon any such alteration or amendment, any outstanding Option granted hereunder may, if the Administrator so determines and if permitted by applicable law, be subject to the more favorable tax treatment afforded to an Optionee pursuant to such terms and conditions.

9.2 Plan Termination. Unless the Plan shall theretofore have been terminated, the Plan shall terminate on the tenth (10th) anniversary of the earlier of the Effective Date and the Approved Date and no Awards may be granted under the Plan thereafter, but Award Agreements then outstanding shall continue in effect in accordance with their respective terms.

ARTICLE 10

CANCELLATION & RESCISSION

10.1 Non-Competition. Unless an Option Agreement specifies otherwise, the Administrator may cancel, rescind, suspend, withhold or otherwise limit or restrict any unexpired, unpaid or deferred Options at any time if the Participant is not in compliance with all applicable provisions of the Option Agreement and the Plan or if the Participant engages in any "Adverse Activity." For purposes of this Section 10.1, "Adverse Activity" shall include: (i) the disclosure to anyone outside the Company, or the use in other than the Company's business, without prior written authorization from the Company, of any confidential information or material relating to the business of the Company, acquired by the Participant either during or after employment with the Company; (ii) the failure or refusal to disclose promptly and to assign to the Company all right, title and interest in any invention or idea, patentable or not, made or conceived by the Participant during employment by the Company, relating in any manner to the actual or anticipated business, research or development work of the Company; or (iii) activity that results in termination of the Participant's employment for Cause.

10.2 Agreement Upon Exercise. Upon exercise, payment or delivery pursuant to an Option Agreement, the Participant shall certify in a manner acceptable to the Company that he or she is in compliance with the terms and conditions of the Plan. In the event a Participant fails to comply with the provisions of clauses (i) through (iii) of Section 10.1 hereof prior to, or during the six (6) months after, any exercise, payment or delivery pursuant to an Option Agreement, such exercise, payment or delivery may be rescinded within two years thereafter. In the event of any such rescission, the Participant shall pay to the Company the amount of any gain realized or payment received as a result of the exercise, payment or delivery, in such manner and on such terms and conditions as may be required, and the Company shall be entitled to set-off against the amount of any such gain any amount owed to the Participant by the Company.

ARTICLE 11

TAX WITHHOLDING

11.1 Withholding. The Company shall have the power to withhold, or require a Participant to remit to the Company in cash, an amount sufficient to satisfy any applicable federal, state, local or foreign tax withholding requirements with respect to any Options exercised, any Restricted Shares issued, or any other Award issued under the Plan. To the extent permissible under applicable tax, securities and other laws, the Administrator may, in its sole discretion and upon such terms and conditions as it may deem appropriate, permit a Participant to satisfy his or her obligation to pay any such tax, in whole or in part, in an amount determined on the basis of the lowest rate of withholding applicable to such Participant, by (a) directing the Company to apply shares of Common Stock to which the Participant is entitled as a result of the exercise of an Award or as a result of the purchase of or lapse of restrictions on an Award, or (b) delivering to the Company shares of Common Stock owned by the Participant. The shares of Common Stock so applied or delivered in satisfaction of the Participant's tax withholding obligation shall be valued at their Fair Market Value as of the date of withholding based on the minimum statutory withholding rates for income tax and payroll tax purposes that are applicable to such supplemental taxable income.

11.2 Shares Withheld to Satisfy Withholding; Restricted Shares. Any shares of Common Stock received by the Company pursuant to Section 11.1 above with respect to Restricted Shares above shall not count against the applicable limits set forth in Article 4 hereof and shall again become available for grant or issuance under the Plan.

11.3 Shares Withheld to Satisfy Withholding; Awards other than Restricted Shares. Any shares of Common Stock received by the Company pursuant to Section 11.1 above with respect to Awards other than Restricted Shares shall be held by the Company as treasury shares and shall count against the applicable limits set forth in Article 4 hereof and shall not again become available for grant or issuance under the Plan.

ARTICLE 12

MISCELLANEOUS

12.1 Repricings Not Permitted. Notwithstanding anything herein to the contrary, the Administrator shall not have the authority to cause the repricing of any outstanding Options either through an adjustment to the Exercise Price or through the cancellation of an Option and regrant of a new Option or other Award in exchange for the cancelled Option (a "Repricing"), unless such Repricing is approved by a majority of the Company's stockholders entitled to vote on such matter.

12.2 Benefits Not Alienable. For so long as it is subject to any restrictions pursuant to this Plan or an Award Agreement, no Award or interest or right therein or part thereof shall be liable for the debts, contracts, or engagements of the Participant or his or her successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment, or any other means whether such disposition be voluntary or involuntary or by operation of law, by judgment, levy, attachment, garnishment, or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that nothing in this Plan shall prevent transfers by will or the applicable laws of descent and distribution or assignments pursuant to a DRO entered by a court of competent jurisdiction.

12.3 No Enlargement of Employee Rights. This Plan is strictly a voluntary undertaking on the part of the Company and shall not be deemed to constitute a contract between the Company and any Participant to be consideration for, or an inducement to, or a condition of, the employment of any Participant. Nothing contained in the Plan shall be deemed to give the right to any Participant to be retained as an employee of the Company or any Affiliated Company or to interfere with the right of the Company or any Affiliated Company to discharge any Participant at any time.

12.4 Application of Funds. The proceeds received by the Company from the sale of Common Stock pursuant to Award Agreements, except as otherwise provided herein, will be used for general corporate purposes.

12.5 Annual Reports. During the term of this Plan, the Company will furnish to each Participant who does not otherwise receive such materials, copies of all reports, proxy statements and other communications that the Company distributes generally to its stockholders.

12.6 Applicable Law. The validity, construction, interpretation and effect of this Plan and all Award Agreements hereunder shall be governed by and determined in accordance with the laws of the State of Washington except for matters of corporate law, in which case the provisions of the Delaware General Corporation Law shall govern.