WATSON PHARMACEUTICALS INC
Form 10-Q
May 10, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006

or

**o 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 0-20045

WATSON PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Nevada	**95-3872914**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

311 Bonnie Circle

Corona, CA 92880-2882

(Address of principal executive offices, including zip code)

(951) 493-5300

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

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

The number of shares outstanding of the Registrant s only class of common stock as of May 4, 2006 was approximately 111,410,000.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited; in thousands)

		March 31, 2006		December 31, 2005
ASSETS				
Current assets:				
Cash and cash equivalents	$	559,734	$	467,451
Marketable securities		168,127		162,475
Accounts receivable, net		269,755		333,832
Inventories		300,794		278,062
Prepaid expenses and other current assets		30,951		31,014
Deferred tax assets		98,243		87,596
Total current assets		1,427,604		1,360,430
Property and equipment, net		451,190		436,149
Investments and other assets		62,482		50,318
Deferred tax assets		25,355		25,733
Product rights and other intangibles, net		710,872		751,808
Goodwill		479,859		455,595
Total assets	$	3,157,362	$	3,080,033
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable and accrued expenses	$	209,690	$	211,160
Income taxes payable		62,918		28,789
Current portion of long-term debt		29,933		
Deferred revenue		4,108		5,721
Total current liabilities		306,649		245,670
Long-term debt		573,947		587,935
Deferred revenue		14,251		13,891
Other long-term liabilities		2,052		2,504
Deferred tax liabilities		120,666		125,792
Total liabilities		1,017,565		975,792
Commitments and contingencies				
Stockholders equity:				
Preferred stock				
Common stock		367		367
Additional paid-in capital		921,074		923,619
Unearned compensation				(9,326)
Retained earnings		1,510,331		1,485,100
Accumulated other comprehensive income		8,025		4,481
Treasury stock, at cost		(300,000)		(300,000)
Total stockholders equity		2,139,797		2,104,241
Total liabilities and stockholders equity	$	3,157,362	$	3,080,033

See accompanying Notes to Condensed Consolidated Financial Statements.

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WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited; in thousands, except per share amounts)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005 Restated
Net revenues	$ 407,233	$ 400,828
Cost of sales (excludes amortization, presented below)	234,754	206,950
Gross profit	172,479	193,878
Operating expenses:		
Research and development	29,837	28,838
Selling, general and administrative	66,750	63,651
Amortization	41,100	40,638
Total operating expenses	137,687	133,127
Operating income	34,792	60,751
Other income (expense):		
(Losses) earnings on equity method investments	(192)	122
Gain on sales of securities	3,695	
Loss on early extinguishment of debt	(720)	
Interest income	6,252	4,106
Interest expense	(3,301)	(3,290)
Other expense	105	(224)
Total other income, net	5,839	714
Income before income taxes	40,631	61,465
Provision for income taxes	15,399	22,852
Net income	$ 25,232	$ 38,613
Earnings per share:		
Basic	$ 0.25	$ 0.35
Diluted	$ 0.23	$ 0.32
Weighted average shares outstanding:		
Basic	101,615	109,136
Diluted	116,541	124,104

See accompanying Notes to Condensed Consolidated Financial Statements.

WATSON PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in thousands)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005 Restated
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 25,232	$ 38,613
Reconciliation to net cash provided by operating activities:		
Depreciation	12,074	9,365
Amortization	41,100	40,638
Deferred income tax benefit	(18,066)	(56)
Provision for inventory reserve	5,484	22,014
Restricted stock and stock option compensation	2,850	
Losses (earnings) on equity method investments	192	(122)
Gain on sale of securities	(3,695)	
Loss on early extinguishment of debt	720	
Tax benefits from employee stock plans	185	1,490
Mark to market on derivative	(453)	(569)
Other	(879)	(1,992)
Changes in assets and liabilities (net of acquisition of business):		
Accounts receivable, net	64,440	21,435
Inventories	(23,698)	(15,493)
Prepaid expenses and other current assets	1,698	4,665
Accounts payable and accrued expenses	(4,524)	(11,226)
Deferred revenue	(1,253)	(1,438)
Income taxes payable	34,129	(2,867)
Other assets	174	910
Total adjustments	110,478	66,754
Net cash provided by operating activities	135,710	105,367
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(9,600)	(10,294)
Acquisition of product rights	(165)	(25)
Acquisition of business, net of cash acquired	(29,578)	
Proceeds from sale of marketable equity securities	893	
Proceeds from sale of investments	4,695	
Additions to marketable securities	(898)	
Additions to long-term investments	(12,500)	
Other investing activities, net	(16)	
Net cash used in investing activities	(47,169)	(10,319)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase of common stock		(69,078)
Principal payments on acquisition liabilities	(3)	(2)
Proceeds from stock plans	3,745	8,764
Net cash provided by (used in) financing activities	3,742	(60,316)
Net increase in cash and cash equivalents	92,283	34,732
Cash and cash equivalents at beginning of period	467,451	298,653
Cash and cash equivalents at end of period	$ 559,734	$ 333,385

See accompanying Notes to Condensed Consolidated Financial Statements.

WATSON PHARMACEUTICALS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 GENERAL

Watson Pharmaceuticals, Inc. (Watson or the Company) is primarily engaged in the development, manufacture, marketing, sale and distribution of brand and off-patent (generic) pharmaceutical products. Watson was incorporated in 1985 and began operations as a manufacturer and marketer of off-patent pharmaceuticals. Through internal product development and synergistic acquisitions of products and businesses, the Company has grown into a diversified specialty pharmaceutical company. Watson operates manufacturing, distribution, research and development and administrative facilities primarily in the United States of America (U.S.).

The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2005. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted from the accompanying Condensed Consolidated Financial Statements. The year end balance sheet was derived from the audited financial statements. The accompanying interim financial statements are unaudited, but reflect all adjustments which are, in the opinion of management, necessary to present fairly Watson s consolidated financial position, results of operations and cash flows for the periods presented. Unless otherwise noted, all such adjustments are of a normal, recurring nature. Certain reclassifications, none of which affected net income or retained earnings, have been made to prior period amounts to conform to current period presentation. The Company s results of operations and cash flows for the interim periods are not necessarily indicative of the results of operations and cash flows that it may achieve in future periods or for the full year.

In the year ended December 31, 2005 the Company acquired additional common shares in Scinopharm Taiwan, Ltd. (Scinopharm), previously accounted for under the cost method, to an ownership level in excess of 20%. Accordingly, as required by Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock (APB 18), results of operations, earnings per share and cash flows from operating and investing activities have been restated for the three months ended March 31, 2005 to conform to current period presentation.

Merger Agreement with Andrx Corporation

On March 13, 2006, the Company announced a definitive merger agreement to acquire all the outstanding shares of common stock of Andrx Corporation (Nasdaq: ADRX) (Andrx) in an all-cash transaction for $25 per share, or total consideration of approximately $1.9 billion. Andrx distributes pharmaceutical products primarily to independent and chain pharmacies and physicians offices and is considered a leader in formulating and commercializing difficult-to-replicate controlled-release pharmaceutical products and selective immediate-release products.

The consummation of the merger is subject to customary closing conditions, including approval of the transaction by Andrx stockholders and the receipt of applicable U.S. regulatory approvals. On May 3, 2006, the Company and Andrx announced they had each received a request from the Federal Trade Commission (FTC) for additional information under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR Act), in connection with Watson s pending acquisition of Andrx. The effect of this second request by the FTC is to extend the waiting period imposed by the HSR Act until 30 days after both Watson and Andrx have substantially complied with the request. For additional information on Andrx, see the U.S. Securities and Exchange Commission s (SEC) website at www.sec.gov.

Comprehensive Income

Comprehensive income includes all changes in equity during a period except those that resulted from investments by or distributions to the Company s stockholders. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that, under generally accepted accounting principles, are included in comprehensive income (loss), but excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity. Watson s other comprehensive income (loss) is comprised of unrealized gains (losses) on its holdings of publicly traded debt and equity securities, net of realized gains (losses) included in net income and foreign currency translation adjustments. The components of comprehensive income including attributable income taxes consisted of the following (in thousands):

	Three Months Ended March 31, 2006	2005 Restated
Net income	$ 25,232	$ 38,613
Other comprehensive income (loss):		
Unrealized gain (loss) on securities	5,442	(3,499)
Less related income taxes	(2,063)	1,305
Total unrealized gain (loss) on securities, net	3,379	(2,194)
Translation gains	165	
Total other comprehensive income (loss)	3,544	(2,194)
Total comprehensive income	$ 28,776	$ 36,419

Preferred and Common Stock

As of March 31, 2006 and December 31, 2005 there were 2,500,000 shares of no par value per share preferred stock authorized, with none issued. As of March 31, 2006 and December 31, 2005, there were 500,000,000 shares of $0.0033 par value per share common stock authorized, with 111,356,000 and 110,205,000 shares issued, respectively. Of the issued shares, 9,399,800 shares were held as treasury shares as of March 31, 2006 and December 31, 2005, respectively.

Stock Repurchases

During 2005, we repurchased approximately 9.4 million shares of our common stock at an aggregate cost of $300.0 million under the Company s $300.0 million stock repurchase program approved by the Board of Directors of Watson (Board) on February 10, 2005 (the 2005 Repurchase Program). This completed our stock repurchase under the 2005 Repurchase Program.

On February 15, 2006, the Board authorized the expenditure of an additional $300.0 million to repurchase shares of the Company s outstanding common stock (the 2006 Repurchase Program). Repurchases are authorized to be made in open market or privately negotiated transactions from time to time in compliance with the SEC Rule 10b-18, subject to market conditions, applicable legal requirements and other factors. Additionally, the Board has authorized that purchases may be made under Rule 10b5-1 promulgated under the Securities and Exchange Act of 1934, as amended. A Rule 10b5-1 plan allows Watson to repurchase its shares during periods when it would normally not be active in the market due to its internal trading blackout periods. All such purchases must be made in accordance with a pre-defined plan that is established when the plan administrator is not aware of any material non-public information. At this time, the Company does not intend to repurchase common stock under the 2006 Repurchase Program as a result of its pending acquisition of Andrx.

Provisions for Sales Returns and Allowances

As customary in the pharmaceutical industry, the Company s gross product sales are subject to a variety of deductions in arriving at reported net product sales. When the Company recognizes revenue from the sale of its products, an estimate of various sales returns and allowances is recorded which reduces product sales and accounts receivable. These adjustments include estimates for chargebacks, rebates, returns, and other sales allowances. These provisions are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and current contract sales terms with wholesale and indirect customers.

The Company s provision for chargebacks is the most significant and complex estimated sales allowance. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to the Company by our wholesale customer for a particular product and the negotiated contract price that the wholesaler s customer pays for that product. The Company s chargeback estimates take into consideration the current average chargeback rates by product and estimated wholesaler inventory levels. Watson continually monitors the assumptions giving consideration to current pricing trends and estimated wholesaler inventory levels and make adjustments to these estimates when the Company believes that the actual chargeback amounts payable in the future will differ from original estimates. The following table summarizes the activity in the Company s major categories of sales returns and allowances (in thousands):

	Chargebacks	Rebates	Returns and Other Allowances	Cash Discounts	Total
Balance at December 31, 2004	$ 129,551	$ 148,948	$ 44,483	$ 10,614	$ 333,596
Provision related to sales in first quarter 2005	191,725	76,409	32,788	13,709	314,631
Credits and payments	(227,678)	(104,597)	(37,512)	(14,153)	(383,940)
Balance at March 31, 2005	93,598	120,760	39,759	10,170	264,287
Provision related to sales in three quarters ended December 31, 2005	744,099	269,461	87,085	45,791	1,146,436
Credits and payments	(698,092)	(261,928)	(81,551)	(43,867)	(1,085,438)
Balance at December 31, 2005	139,605	128,293	45,293	12,094	325,285
Provision related to sales in first quarter 2006	255,933	90,199	38,771	15,479	400,382
Credits and payments	(258,087)	(110,058)	(46,868)	(16,058)	(431,071)
Balance at March 31, 2006	$ 137,451	$ 108,434	$ 37,196	$ 11,515	$ 294,596

The balance of the Company s allowances for rebates has declined due to efficiencies in processing as well as an acceleration in the frequency of payments. The increase in the balance of the Company s chargeback allowances is the result of changes in our customer inventory mix.

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding during a period. Diluted earnings per share is based on the treasury stock method and includes the effect from potential issuance of common stock, such as shares issuable upon conversion of the $575 million convertible contingent senior debentures (CODES), and the dilutive effect of stock options and restricted stock awards outstanding during the period. Common share equivalents have been excluded where their inclusion would be anti-dilutive. In accordance with Emerging Issues Task Force (EITF) Issue No. 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings per Share, the Company is required to add approximately 14.4 million shares associated with the conversion of the CODES to the number of shares outstanding for the calculation of diluted earnings per share for all periods in which the securities were outstanding. A reconciliation of the numerators and denominators of basic and diluted earnings per share consisted of the following (in thousands, except per share amounts):

	Three months ended March 31, 2006	Three months ended March 31, 2005 Restated
Earnings per share - basic		
Net income	$ 25,232	$ 38,613
Basic weighted average common shares outstanding	101,615	109,136
Earnings per share - basic	$ 0.25	$ 0.35
Earnings per share - assuming dilution		
Net income	$ 25,232	$ 38,613
Add: Interest expense on CODES, net of tax	1,675	1,621
Net income, adjusted	$ 26,907	$ 40,234
Basic weighted average common shares outstanding	101,615	109,136
Effect of dilutive securities:		
Conversion of CODES	14,357	14,357
Dilutive stock options	569	611
Diluted weighted average common shares outstanding	116,541	124,104
Earnings per share - diluted	$ 0.23	$ 0.32

Stock awards to purchase 7.9 million and 6.6 million common shares for the three month periods ended March 31, 2006 and 2005, respectively, were outstanding but were not included in the computation of diluted earnings per share because the options were antidilutive.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, Inventory Costs-an Amendment of ARB No. 43, Chapter 4 (SFAS 151). SFAS 151 clarifies that items such as abnormal freight, handling costs, and wasted materials (spoilage) be recognized as current period charges rather than as a portion of the inventory cost. Unallocated overheads are to be recognized as an expense in the period in which they are incurred. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The provision of this Statement shall be applied prospectively. The adoption of SFAS 151 on January 1, 2006, did not have a material effect on our Condensed Consolidated Financial Statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which replaces SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123) as well as SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure (SFAS 148), supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25 and amends SFAS No. 95, Statement of Cash Flows (SFAS 95). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The intrinsic value method as permitted under APB 25 together with the pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. Under SFAS 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for attributing compensation cost to reporting periods and the transition method to be used at date of adoption. The transition methods include modified prospective and modified retrospective adoption options. Under the modified retrospective option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The modified prospective method requires that compensation expense be recorded for all unvested stock options at the beginning of the first quarter of adoption of SFAS 123R, while the modified retrospective method would record compensation expense for all unvested stock options beginning with the first period restated. SFAS 123R also requires any previously recorded unearned or deferred compensation accounts (i.e. contra-equity accounts) within stockholders equity be recorded as a reduction to additional paid-in capital balances rather than shown as contra equity accounts as was permitted prior to January 1, 2006. SFAS 95 is amended to require excess tax benefits be reported as a financing cash flow rather than as a reduction in taxes paid within the Consolidated Statement of Cash Flows. On January 1, 2006, the Company adopted SFAS 123R using the modified prospective method option.

In March 2005, the SEC issued SEC Staff Bulletin No. 107 (SAB 107) which describes the SEC staff position as well as supplemental implementation guidance on the application and adoption of SFAS 123R. The Company has applied the provisions of SAB 107 and its guidance in its adoption of SFAS 123R on January 1, 2006 (Refer to NOTE 2 SHARE-BASED COMPENSATION).

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154), which replaces APB Opinion No. 20, Accounting Changes (APB 20) and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements (SFAS 3). SFAS 154 applies all voluntary changes in accounting principle and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 also requires retrospective application to prior period financial statements involving changes in accounting principle unless it is impracticable to determine either the period-specific or cumulative effect of the change. This statement also requires that a change in the method of depreciation, amortization or depletion of long-lived assets be accounted for as a change in accounting estimate that is accounted for prospectively. SFAS 154 also retains many provisions of APB 20 including those related to reporting a change in accounting estimate, a change in the reporting entity and a correction of an error and also carries forward provisions of SFAS 3 governing the reporting of accounting changes in interim financial statements. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 on January 1, 2006, did not have a material effect on our Consolidated Financial Statements.

NOTE 2 SHARE-BASED COMPENSATION

As indicated above, effective January 1, 2006, the Company adopted the modified prospective method of SFAS 123R which requires the measurement and recognition of compensation expense for all share-based compensation awards made to employees and directors based on estimated fair values. SFAS 123R eliminates previously available alternatives to account for share-based compensation transactions, as the Company formerly did, using the recognition and measurement principles of APB 25 and related interpretations. Under the intrinsic value method of APB 25, no stock-based employee compensation expense had been recognized for employee options in the Company s Condensed Consolidated Statements of Income, as all employee options granted under the Company s stock option plans or employee stock purchase plan (ESPP) either had an exercise price equal to the market value of the underlying common stock on the date of grant or were deemed non-compensatory under APB 25 for common stock issued under our ESPP. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the share-based compensation impact of FAS 123R.

Stock Option Plans

The Company has adopted several stock option plans, all of which have been approved by the Company s shareholders, that authorize the granting of options to purchase the Company s common shares subject to certain conditions. At March 31, 2006, the Company had reserved 15.3 million of its common shares for issuance of

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

The Company estimates the fair value of its stock option plans and the ESPP using the Black-Scholes option pricing model (the Option Model). The Option Model requires the use of subjective and complex assumptions, including the option s expected term and the estimated future price volatility of the underlying stock, which determine the fair value of the share-based awards. The Company s estimate of expected term in 2006 was determined based on the weighted average period of time that options granted are expected to be outstanding considering current vesting schedules and the historical exercise patterns of existing option plans. Beginning in 2005, the expected volatility assumption used in the Option Model changed from being based on historical volatility to implied volatility based on traded options on the Company s stock in accordance with guidance provided in SFAS 123R and SAB 107. Prior to 2005, the Company s measurement of expected volatility was based on the historical volatility of its stock. The risk-free interest rate used in the Option Model is based on the yield of U.S. Treasuries with a maturity closest to the expected term of the Company s stock options.

The following weighted average assumptions were used for stock options granted during the three months ended March 31, 2006 and 2005:

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Dividend yield	None	None
Expected volatility	25%	26%
Risk-free interest rate	4.67%	4.00%
Expected term	4.8 years	5.5 years
Weighted average fair value per share at grant date	$ 9.25	$ 9.87

Effective January 1, 2006, in accordance with the provisions of SFAS 123R, share-based compensation expense recognized during a period is based on the value of the portion of share-based awards that are expected to vest with employees. Accordingly, the recognition of share-based compensation expense beginning January 1, 2006 has been reduced for estimated future forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant with adjustments recorded in subsequent period compensation expense if actual forfeitures differ from those estimates. Prior to 2006, we accounted for forfeitures as they occurred for the disclosure of pro forma information presented in our Notes to Condensed Consolidated Financial Statements for prior periods. Share-based compensation expense recognized under SFAS 123R includes share-based awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R as well as share-based awards granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123. In conjunction with the adoption of SFAS 123R, we changed the method of recognizing share-based compensation expense from the accelerated multiple-option approach to the ratable single-option approach.

As a result of adopting SFAS 123R on January 1, 2006, the Company s operating income and net income before income tax provision was reduced by $1.8 million and net income was reduced by $1.1 million ($0.02 per basic share, $0.01 per diluted share) for the three months ended March 31, 2006, related to the Company s employee stock option plans. There was no share-based employee compensation related expense recognized in the three months ended March 31, 2005. Total stock option cost capitalized as part of inventory was $0.3 million and $0 for three months ended March 31, 2006 and 2005, respectively.

On December 15, 2005 the Compensation Committee of the Board approved the accelerated vesting of certain unvested, out-of-the-money stock options having an exercise price of $38.00 or greater. The acceleration of vesting was effective December 15, 2005, for stock options previously awarded to the Company s employees, including its executive officers under the Company s equity compensation plans. In connection with the acceleration of vesting terms of these options, the Company recognized an additional $6.9 million, pre-tax non-cash compensation expense on a pro forma basis in accordance with SFAS 123 in the three months ended December 31, 2005. The acceleration action was taken in order to reduce the impact on future compensation expense of recognizing share based payment transactions within future periods consolidated statements of income upon adoption of SFAS 123R on January 1, 2006.

A summary of the changes in the Company s stock option plans during the three months ended March 31, 2006 is presented below (in thousands, except per share amounts):

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value