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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

OR

[ ] TRANSACTION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________________ TO_________________

COMMISSION FILE NUMBER 1-10113

HALSEY DRUG CO., INC.
(Exact name of registrant as specified in its charter)

NEW YORK	11-0853640
(State or other Jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

616 N. NORTH COURT, SUITE 120 PALATINE, ILLINOIS	60067
(Address of Principal Executive Offices)	(Zip Code)

(847) 705-7709
(Registrant's telephone number, including area code)

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

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 [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

As of August 6, 2004 the registrant had 21,927,943 shares of Common Stock, $.01 par value, outstanding.

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HALSEY DRUG CO., INC. & SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HALSEY DRUG CO., INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	UNAUDITED JUNE 30, 2004	DECEMBER 31, 2003
	(IN THOUSANDS)	
ASSETS		
CURRENT ASSETS		
Cash	$ 6,583	$ 942
Accounts Receivable - net of allowance for doubtful accounts of $428 at December 31, 2003	-	467
Inventories	-	312
Prepaid expenses and other current assets	216	401
Total current assets	6,799	2,122
PROPERTY, PLANT & EQUIPMENT, NET	3,171	3,394
DEFERRED PRIVATE OFFERING COSTS, net of accumulated amortization of $561 and $318 at June 30, 2004 and December 31, 2003, respectively	795	714
OTHER ASSETS AND DEPOSITS	40	392
TOTAL ASSETS	$10,805	$ 6,622

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

HALSEY DRUG CO., INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	UNAUDITED JUNE 30, 2004	DECEMBER 31, 2003
	(IN THOUSANDS,EXCEPT PER SHARE DATA)	
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Convertible subordinated debentures	$ 14,000	$ -
Less: debt discount	(2,793)	-
....	11,207	-
Current maturities of notes payable and capital lease obligations	27	45
Accounts payable	-	1,895
Accrued interest	3,478	1,544
Accrued expenses	1,065	2,108
Deferred asset proceeds	2,000	-
Department of Justice Settlement	-	300
Total current liabilities	17,777	5,892
SENIOR SECURED TERM NOTE PAYABLE	5,000	21,401
BRIDGE LOANS	-	2,000
Less: debt discount	-	(568)
	-	1,432
CONVERTIBLE SUBORDINATED DEBENTURES	86,632	86,632
Less: debt discount	(44,247)	(56,893)
	42,385	29,739
CAPITAL LEASE OBLIGATIONS	79	92
DEPARTMENT OF JUSTICE SETTLEMENT	-	133
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock - $.01 par value; authorized 80,000,000 shares; issued and outstanding, 21,716,025 and 21,601,704 shares at June 30, 2004 and December 31, 2003, respectively	217	216
Additional paid-in capital	171,324	157,262
Accumulated deficit	(225,977)	(209,545)
STOCKHOLDERS' DEFICIT	(54,436)	(52,067)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 10,805	$ 6,622

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

HALSEY DRUG CO., INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE DATA)

	JUNE 30,			
	FOR THE SIX MONTHS ENDED		FOR THE THREE MONTHS ENDED	
	2004	2003	2004	2003
Net product revenues	$ 838	$ 2,732	$ 210	$ 1,206
Cost of manufacturing	1,437	5,138	184	2,265
Research and development	1,242	616	1,004	287
Selling, general and administrative expenses	2,363	3,917	1,142	2,206
Loss from operations	(4,204)	(6,939)	(2,120)	(3,552)
Other income (expense)				
Interest expense	(2,152)	(2,904)	(1,194)	(1,471)
Interest income	22	21	15	4
Amortization of deferred debt discount and private offering costs	(24,655)	(11,683)	(13,812)	(5,916)
Gain (loss) on asset disposals	1,755	--	1	--
Gain on debt restructure	12,401	--	--	--
Other	401	(97)	(2)	(92)
NET LOSS	$ (16,432)	$ (21,602)	$ (17,112)	$ (11,027)
Basic and diluted loss per share	$ (0.76)	$ (1.03)	$ (0.79)	$ (0.52)
Weighted average number of outstanding shares	21,612,382	21,065,373	21,623,061	21,095,092

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30 2004	2003
	(IN THOUSANDS)	
Cash flows from operating activities		
Net loss	$(16,432)	$(21,602)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	251	402
Amortization of deferred debt discount and private offering costs	24,655	11,683
Amortization of deferred product acquisition costs	205	23
Debentures and stock issued for interest	63	1,459
Loss on disposal of assets	71	5
Increase in fair value of warrants	-	92
Gain on restructure of debt	(12,401)	-
Changes in assets and liabilities		
Accounts receivable	315	(1,295)
Inventories	312	(252)
Prepaid expenses and other current assets	182	(292)
Other assets and deposits	149	48
Accounts payable	(1,895)	(310)
Accrued expenses	2,776	1,279
Total adjustments	14,683	12,842
Net cash used in operating activities	(1,749)	(8,760)
Cash flows from investing activities		
Capital expenditures	(99)	(719)
Proceeds from disposal of assets	2	-
Net cash used in investing activities	(97)	(719)
Cash flows from financing activities		
Payments on notes payable and capital lease obligations	(4,030)	(20)
Proceeds from issuance of debentures	11,951	500
Payments to Department of Justice	(434)	(162)
Net cash provided by financing activities	7,487	318
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	5,641	(9,161)
Cash and cash equivalents at beginning of period	942	9,211
Cash and cash equivalents at end of period	$ 6,583	$ 50

Cash paid for interest was $47 during the six months ended June 30, 2004.

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES FOR THE SIX MONTHS ENDED JUNE 30, 2004:

1. The Company's Convertible Subordinated Debentures contained beneficial conversation features, which were valued at $14,000,000.

2. The Company has repaid $166,000 of indebtedness in the form of product deliveries.

3. Bridge Loans of $2,000,000 and accrued interest of $49,000 were converted into like amounts of Convertible Subordinated Debentures.

4. The Company has issued 114,322 shares of common stock as payment of $63,000 of Senior Secured Term Note Payable accrued interest.

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

SIX MONTHS ENDED JUNE 30, 2004

(IN THOUSANDS, EXCEPT SHARE DATA)

(UNAUDITED)

	COMMON STOCK $.01 PAR VALUE		ADDITIONAL PAID-IN	ACCUMULATED	
	SHARES	AMOUNT	CAPITAL	DEFICIT	TOTAL
Balance at January 1, 2004	21,601,704	$ 216	$ 157,262	$(209,545)	$ (52,067)
Net loss for the six months ended June 30, 2004				(16,432)	(16,432)
Issuance of common shares for payment of interest	114,321	1	62		63
Beneficial conversion features in connection with issuance of debentures			14,000		14,000
Balance at June 30, 2004	21,716,025	$ 217	$ 171,324	$(225,977)	$ (54,436)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Halsey Drug Co., Inc. and subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accrual adjustments, considered necessary to present fairly the financial position, results of operations and changes in cash flows for the six months ended June 30, 2004, assuming that the Company will continue as a going concern, have been made. The results of operations for the six month' period ended June 30, 2004 are not necessarily indicative of the results that may be expected for the full year ended December 31, 2004. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto for the year ended December 31, 2003 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

At June 30, 2004 the Company had cash and cash equivalents of $6,583,000 as compared to $942,000 at December 31, 2003. The Company had working capital deficit at June 30, 2004 of $10,978,000 and an accumulated deficit of $225,977,000. The Company had an operating loss of $4,204,000 during the six months ended June 30, 2004.

In the fourth quarter of 2003 and first quarter of 2004, the Company restructured its operations, as more fully described in Note 2, and ceased the manufacturing, sale and distribution of the Company's generic finished dosage pharmaceutical products by the Company's subsidiary, Axiom Pharmaceutical Corporation ("Axiom"). Axiom's manufacturing operations ceased on January 30, 2004, packaging and labeling operations ceased approximately February 12, 2004 and quality assurance and related support activities ceased on approximately February 27, 2004.

As restructured, the Company is engaged in the development of proprietary opioid abuse deterrent formulation technology (the "ADF Technology"), the manufacture, packaging and stability testing of clinical trial supplies of finished product candidates utilizing the ADF Technology, the evaluation of such product candidates in appropriate clinical trials, the development and scale up of novel active pharmaceutical ingredient ("API") opioid synthesis technologies (the "Opioid Synthesis Technologies"), and the prosecution of the Company's application to the Drug Enforcement Administration ("DEA") for a registration to import narcotic raw materials ("NRMs"). The Company proposes to enter into license agreements with strategic partners providing that such licensees will further develop abuse deterrent formulation finished dosage product candidates, file for regulatory approval with the U.S. Food and Drug Administration ("FDA") and other regulatory authorities and commercialize such products. The Company intends to manufacture commercial supplies of such products for sale by the Company's licensees.

NOTE 2 - LIQUIDITY MATTERS

General

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. At December 31, 2003, the Company had cash and cash equivalents of $942,000, working capital deficit of $3,770,000 and a stockholders' deficit of $52,067,000. The Company incurred a loss from operations of $17,244,000 and a net loss of $48,455,000 during the year ended December 31, 2003. At June 30, 2004, the Company had cash and cash equivalents of $6,583,000, a working capital deficit of $10,978,000 and an accumulated deficit of $225,977,000. The Company incurred operating losses of $4,204,000 during the six months ended June 30, 2004. Historically, the Company has incurred significant losses from operations and until such time as its research and development efforts are commercialized, for which no assurance can be given, the Company will continue to incur operating losses. These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with respect to these matters follow.

Company Restructuring

On November 6, 2003, the Company publicly announced a restructuring plan to focus its efforts on research and development related to certain proprietary finished dosage products and opioid APIs. In making its determination the Board of Directors considered, among other factors, the Company's ability and time required to generate positive cash flow and income from the operation of the Company's finished dosage manufacturing, packaging, labeling and distribution facilities located in Congers, New York (collectively, the "Congers Facilities") in the manufacture and distribution of finished dosage generic products pursuant to abbreviated new drug applications ("ANDAs").

The Company incurred losses of $48.5 million in 2003, $59.6 million in 2002 and $12.6 million in 2001. The Board determined that near term sales of the Company's finished dosage generic products would likely result in continued financial losses in view of the highly competitive market environment, low market pricing, declining market size for its existing generic products and the lack of timely new generic product launches. Based on this analysis and other factors, the Board concluded that the Company restructure its operations by closing or divesting the Congers Facilities and reducing certain activities at its Culver, Indiana facility (the "Culver Facility"). The plan targeted a reduction in workforce of approximately 70 employees at the Congers Facilities, 25 employees at the Culver Facility and 5 employees at the Rockford, Illinois office facility (the "Rockford Office").

In implementing the restructuring plan at the Culver Facility, the reduction in work force involved approximately 25 employees engaged primarily in or supporting the manufacture of doxycycline hyclate and doxycycline monohydrate APIs, which were converted to finished dosage products at the Congers Facilities. With the closure of the Congers Facilities, the doxycycline APIs manufactured at the Culver Facility were not required. The Culver Facility work force reduction was completed by December 31, 2003.

In implementing the restructuring plan at the Rockford Office, the Company terminated its Rockford office lease agreement and relocated the administrative functions to Palatine, Illinois. This process was completed on February 29, 2004 resulting in a reduction in work force of 5 employees.

In implementing the restructuring of operations at the Congers Facilities, the reduction in work force involved essentially all of the employees at the site. Finished generic product manufacturing operations ceased on January 30, 2004. Packaging and labeling operations ceased approximately February 12, 2004 and quality assurance and related support activities ceased on February 27, 2004. Such dates also mark the substantial completion of the reduction in work force of approximately 70 employees engaged in these activities at the Congers Facilities. From approximately March 1, 2004 to March 19, 2004 a small logistics, maintenance and warehouse staff prepared the Congers Facilities for sale to IVAX Pharmaceuticals as discussed below under the caption "Sale of Certain Company Assets to IVAX".

In implementing the restructuring adopted by the Board, the Company has transitioned to a single vertically integrated operations facility located in Culver, Indiana. The Company's strategy and key activities to be conducted at the Culver Facility are as follows:

- Development of the Company's ADF Technology for use in orally administered opioid finished dosage product candidates.

- Manufacture and quality assurance release of clinical trial supplies of certain finished dosage form product candidates utilizing the ADF Technology.

- Evaluation of certain finished dosage product candidates utilizing the ADF Technology in clinical trials.

- Scale-up and manufacture of commercial quantities of certain product candidates utilizing the ADF Technology for sale by the Company's licensees.

- Research, development and scale up of the Company's novel Opioid Synthesis Technologies.

- Prosecution of the Company's application to the DEA to for registration to import NRMs for use in the production of opioid API's utilizing the Company's Opioid Synthesis Technologies.

- Negotiating and executing license and development agreements with strategic pharmaceutical company partners providing that such licensees will further develop certain finished dosage product candidates utilizing the ADF Technology, file for regulatory approval with the FDA and other regulatory authorities and commercialize such products.

As of December 31, 2003, the Company has recorded aggregate restructuring expenses of approximately $3,280,000 consisting of an impairment charge of $1,673,000 against property, plant and equipment, an impairment charge of $1,354,000 against inventory (charged against cost of sales), and $253,000 of other costs.At December 31, 2003, $100,000 of other costs were included in accrued expenses. During the six months ended June 30, 2004, $41,000 of such costs were paid and there remains $59,000 accrued at June 30, 2004.

2004 Debenture Offering

On February 6, 2004, the Company consummated a private offering of convertible senior secured debentures (the "2004 Debentures") in the aggregate principal amount of approximately $12.3 million (the "2004 Debenture Offering"). The 2004 Debentures were issued by the Company pursuant to a certain Debenture and Share Purchase Agreement dated as of February 6, 2004 (the "2004 Purchase Agreement") by and among the Company, Care Capital Investments II, L.P. ("Care Capital"), Essex Woodlands Health Ventures V, L.P. ("Essex"), Galen Partners III, L.P. and certain of its affiliates (collectively, "Galen") and each of the purchasers listed on the signature page thereto (the "2004 Debenture Investor Group"). Of the approximate $12.3 million in debentures issued on February 10, 2004 under the 2004 Debenture Offering, approximately $2.0 million of 2004 Debentures were issued in exchange for the surrender of a like amount of principal plus accrued and unpaid interest under the Company's 2002 Debentures issued to Care Capital, Essex and Galen during November and December, 2003 pursuant to the Letter of Support. As the conversion price of such debentures was less than the fair market value of the Company's common stock on the date of issue, beneficial conversion features were determined to exist. The Company recorded approximately $12.3 million of debt discount limited to the face amount of the new debt, which is being amortized over the life of the debt, which matures July 31, 2004, subject to automatic extension up to October 31, 2004 to allow for the completion of the Company's 2004 Annual Meeting of Shareholders. During the six months ended June 30, 2004, the Company recognized approximately $3.8 million of amortization expense from this transaction.

Additional Funding under 2004 Debenture Offering

On April 14, 2004, the Company completed an additional closing under the 2004 Purchase Agreement pursuant to which the Company issued additional 2004 Debentures in the aggregate principal amount of approximately $0.6 million, bringing the aggregate principal amount of 2004 Debentures issued by the Company under the 2004 Purchase Agreement to $12.9 million. As the conversion price of such debentures was less than the fair market value of the Company's common stock on the date of issue, beneficial conversion features were determined to exist. The Company recorded approximately $0.6 million of debt discount limited to the face amount of the new debt, which will be amortized over the life of the debt, which matures July 31, 2004, subject to automatic extension up to October 31, 2004 to allow for the completion of the Company's 2004 Annual Meeting of Shareholders.

On May 26, 2004, the Company completed an additional closing under the 2004 Purchase Agreement pursuant to which the Company issued additional 2004 Debentures in the aggregate principal amount of approximately $1.1 million, bringing the aggregate principal amount of 2004 Debentures issued by the Company under the 2004 Purchase Agreement to $14.0 million. As the conversion of such debentures was less than the fair market value of the Company's common stock on the date of issue, beneficial conversion features were determined to exist. The Company recorded approximately $1.1 million of debt discount limited to the face amount of the new debt, which will be amortized over the life of the debt, which matures July 31, 2004, subject to automatic extension up to October 31, 2004 to allow for the completion of the Company's 2004 Annual Meeting of Shareholders.

Amendment to 2004 Purchase Agreement

The 2004 Purchase Agreement provided for the issuance by the Company of convertible senior secured debentures in the aggregate principal amount of $14.0 million to be completed no later than June 5, 2004. On June 1, 2004, an Amendment to the 2004 Purchase Agreement was executed providing for (i) an increase the principal amount of debentures issuable by the Company under the 2004 Purchase Agreement from $14.0 million to $17.5 million, and (ii) an extension of the time to complete this additional financing from June 5, 2004 to June 30, 2004 (the "2004 Purchase Agreement Amendment"). No additional 2004 Debentures were issued following the 2004 Purchase Agreement Amendment.

Terms of 2004 Debentures

The 2004 Debentures, issued at par, bear interest at the rate of 1.62% per annum, the short-term Applicable Federal Rate on February 6, 2004. The 2004 Debentures are secured by a lien on all assets of the Company. In addition, each of Houba, Inc. and Axiom Pharmaceutical Corporation, each a wholly-owned subsidiary of the Company, has executed in favor of the 2004 Debenture holders, an unconditional agreement of guaranty of the Company's obligations under the 2004 Purchase Agreement. Each guaranty is secured by all assets of such subsidiaries. In addition, the Company has pledged the stock of each such subsidiary to the holders of the 2004 Debentures to further secure its obligations under the 2004 Purchase Agreement.

Subordination of Lien of Holders of 2004 Debentures to the Lien Under the Watson Term Loan Agreement

In accordance with the terms of an Amended and Restated Subordination Agreement dated as of February 6, 2004 between the Company, the holders of the 2004 Debentures and the holders of the Company's other outstanding debentures, the liens on the Company's and its subsidiary's assets as well as the payment priority of the 2004 Debentures are (i) subordinate to the Company's lien and payment obligations in favor of Watson Pharmaceuticals under the Watson Term Loan Agreement, and (ii) senior to the Company's lien and payment obligations in favor of the holders of the Company's other outstanding debentures in the aggregate principal amount of approximately $86.6 million.

Conversion of 2004 Debentures into Series A Preferred Stock

The 2004 Debentures (including the principal amount plus interest accrued at the date of conversion) will convert automatically into the Company's Series A convertible preferred stock (the "Series A Preferred") immediately following the Company's receipt of shareholder approval at its next shareholders' meeting to restate the Company's Certificate of Incorporation (the "Charter Amendment") to authorize the Series A Preferred and the Junior Preferred Shares (as described below) and the filing of the Charter Amendment with the Office of the New York Department of State (the date of such filing, the "Charter Amendment Filing Date"), as provided in the 2004 Purchase Agreement. The 2004 Debentures will convert into Series A Preferred at a price per share (the "Series A Conversion Price") of $0.6425, representing the average of the closing bid and asked prices of the Company's Common Stock for the twenty (20) trading days ending February 4, 2004, as reported by the Over-the-Counter ("OTC") Bulletin Board. The Series A Conversion Price is subject to adjustment, from time to time, to equal the consideration per share received by the Company for its Common Stock, or the conversion/exercise price per share of the Company's Common Stock issuable under rights or options for the purchase of, or stock or other securities convertible into, Common Stock ("Convertible Securities"), if lower than the then applicable Series A Conversion Price.

Based on the $0.6425 Series A Conversion Price of the Series A Shares and estimating the interest accrual under the 2004 Debentures prior to the Charter Amendment Filing Date, the 2004 Debentures with an aggregate principal amount of $14.0 million will be convertible into an aggregate of approximately 22 million Series A Preferred shares.

Series A Preferred Stock Liquidation Preference, Conversion Right and Participation Right

In general, the Series A Preferred shares have a liquidation preference equal to five (5) times the initial $0.6425 Series A Conversion Price (the "Series A Liquidation Preference"). In addition, the Series A Preferred shares are convertible into the Company's Common Stock, with each Series A Preferred share convertible into the number of shares of Common Stock obtained by dividing (i) the Series A Liquidation Preference, by (ii) the $0.6425 Series A Conversion Price, as such conversion price may be adjusted, from time to time, pursuant to the dilution protections of such shares. Without limiting the Series A Liquidation Preference, the holders of Series A Preferred shares also have the right to participate with the holders of the Company's Common Stock upon the occurrence of a liquidation event, including the Company's merger, sale of all or substantially all of its assets or a change of control transaction, on an as-converted basis (but for these purposes only, assuming the Series A Preferred shares to be convertible into only thirty percent (30%) of the shares of Common Stock into which they are otherwise then convertible). The holders of Series A Preferred shares also have the right to vote as part of a single class with all holders of the Company's voting securities on all matters to be voted on by such security holders. Each holder of Series A Preferred shares will have such number of votes as shall equal the number of votes he would have had if such holder converted all Series A Preferred shares held by such holder into shares of Common Stock immediately prior to the record date relating to such vote.

Nomination of Directors to the Company's Board of Directors by the Lead 2004 Investors

The 2004 Purchase Agreement provides that each of Care Capital, Essex and Galen (collectively, the "Lead 2004 Investors") has the right to designate for nomination one member of the Company's Board of Directors, and that the Lead Investors collectively may designate one additional member of the Board (collectively, the Designees"). The Purchase Agreement further provides that the Designees, if so requested by such Designee in his sole discretion, shall be appointed to any Committee of the Board of Directors. The Designees of Care Capital, Essex and Galen are Messrs. Karabelas, Thangaraj and Wesson, respectively, each of whom are current Board members. Effective as of the closing of the 2004 Purchase Agreement, the Lead 2004 Investors may collectively nominate one additional Designee to the Board. The Company has agreed to nominate and appoint to the Board of Directors, subject to shareholder approval, one designee of each of Care Capital, Essex and Galen, and one collective designee of the Lead 2004 Investors, for so long as each holds a minimum of 50% of the Series A Preferred shares initially issued to such party (or at least 50% of the shares of Common Stock issuable upon conversion of the Series A Preferred shares).

Impact of Conversion of the Company's Outstanding Debentures

As of February 6, 2004, the date of the initial closing of the 2004 Purchase Agreement, the Company had issued and outstanding and aggregate of approximately $86.6 million in principal amount of 5% convertible senior secured debentures maturing March 31, 2006 issued pursuant to three separate Debenture Purchase Agreements dated March 10, 1998, as amended (the "1998 Debentures"), May 26, 1999, as amended (the "1999 Debentures") and December 20, 2002 (the "2002 Debentures"), respectively. The 1998 Debentures, 1999 Debentures and 2002 Debentures are referred to collectively as the "1998-2002 Debentures". After giving effect to the Company's issuance of additional 5% convertible senior secured debentures in satisfaction of interest payments on the 1998-2002 Debentures, as of February 10, 2004, the 1998-2002 Debentures were convertible into an aggregate of approximately

190.4 million shares of the Company's Common Stock.

Conversion Agreement of Holders of 1998-2002 Debentures

Simultaneous with the execution of the 2004 Purchase Agreement, and as a condition to the initial closing of the 2004 Purchase Agreement, the Company, the 2004 Debenture Investor Group and each of the holders of the 1998-2002 Debentures executed a certain Debenture Conversion Agreement, dated as of February 6, 2004 (the "Conversion Agreement"). In accordance with the terms of the Conversion Agreement, each holder of the 2004 Debentures agreed to convert the 2004 Debentures held by such holder into the Company's Series A Preferred shares and each holder of 1998-2002 Debentures agreed to convert the 1998-2002 Debentures held by such holder into the Company's Series B convertible preferred stock (the "Series B Preferred") and/or Series C-1, C-2 and/or C-3 convertible preferred stock (collectively, the "Series C Preferred"). The Series C Preferred shares together with the Series B Preferred shares are herein referred to as, the "Junior Preferred Shares", and the Junior Preferred Shares together with the Series A Preferred, are collectively referred to as the "Preferred Stock". The Conversion Agreement provides, among other things, for the automatic conversion of the 2004 Debentures and the 1998-2002 Debentures (collectively, the "Outstanding Debentures") into the appropriate class of Preferred Stock immediately following the Company's receipt of shareholder approval to the Charter Amendment authorizing the creation of the Preferred Stock and the filing of the Charter Amendment with the Office of the New York Department of State.

Shares of Junior Preferred Stock Resulting from Conversion of 1998-2002 Debentures

Under the Conversion Agreement, the holders of approximately $6.6 million in principal amount of 2002 Debentures issued during 2003 will convert such 2002 Debentures (plus accrued and unpaid interest) into Series B Preferred Shares. Of the remaining approximate $80.0 million in principal amount of the 1998-2002 Debentures, approximately $31.2 million is comprised of 1998 Debentures, approximately $21.5 million is comprised of 1999 Debentures and approximately $27.3 million is comprised of 2002 Debentures. The 1998 Debentures will be converted into Series C-1 Preferred shares. The 1999 Debentures will be converted into Series C-2 Preferred shares. The remaining balance of the 2002 Debentures shall be converted into Series C-3 Preferred shares.

Shares of Common Stock Resulting from Conversion of Junior Preferred Shares

The number of Junior Preferred Shares to be received by each holder of 1998-2002 Debentures is based on the respective prices at which the 1998-2002 Debentures were convertible into Common Stock. The 2002 Debentures issued in 2003 have a conversion price of $0.3420 per share. The 1998 Debentures, 1999 Debentures and the remaining balance of the 2002 Debentures have conversion prices of $0.5776, $0.5993 and $0.3481 per share, respectively. Based on the respective conversion prices of the 1998-2002 Debentures, and estimating the interest accrual on the 1998-2002 Debentures prior to the Charter Amendment Filing Date, the 1998-2002 Debentures are convertible into an aggregate of approximately 20.0 million Series B Preferred shares, 56.5 million Series C-1 Preferred shares, 37.5 million Series C-2 Preferred shares and 80.9 million Series C-3 Preferred shares.

Liquidation Preference of Junior Preferred Shares

In general, the Junior Preferred Shares have a liquidation preference equal to one (1) time the principal amount plus accrued and unpaid interest of the 1998-2002 Debentures converted into Junior Preferred Shares. The liquidation preference of the Series B Preferred has priority over, and will be satisfied prior to, the liquidation preference of the Series C Preferred. The liquidation preference for each class of the Junior Preferred Shares is equal to the conversion prices of such shares. The Junior Preferred Shares are convertible into the Company's Common Stock, with each Junior Preferred Share convertible into one share of Common Stock. The holders of the Junior Preferred Shares have the right to vote as part of the single class with all holders of the Company's Common Stock and the holders of the Series A Preferred on all matters to be voted on by such stockholders, with each holder of Junior Preferred Shares having such number of votes as shall equal the number of votes he would have had if such holder had converted all Junior Preferred Shares held by such holder into Common Stock immediately prior to the record date relating to such vote.

Amendment to Watson Term Loan Agreement

The Company was a party to a certain loan agreement with Watson Pharmaceuticals ("Watson") pursuant to which Watson made term loans to the Company (the "Watson Term Loan Agreement") in the aggregate principal amount of approximately $21.4 million as evidenced by two promissory notes (the "Watson Notes"). It was a condition to the completion of the 2004 Debenture Offering that simultaneous with the closing of the 2004 Purchase Agreement, the Company shall have paid Watson the sum of approximately $4.3 million (which amount was funded from the proceeds of the 2004 Debenture Offering) and conveyed to Watson certain Company assets in consideration for Watson's forgiveness of approximately $16.4 million of indebtedness under the Watson Notes. As part of such transaction, the Watson Notes were amended to extend the maturity date of such notes from March 31, 2006 to June 30, 2007, to provide for satisfaction of future interest payments under the Watson Notes in the form of the Company's Common Stock, to reduce the principal amount of the Watson Notes from $21.4 million to $5.0 million, and to provide for the forbearance from the exercise of rights and remedies upon the occurrence of certain events of default under the Watson Notes (the Watson Notes as so amended, the "New Watson Note"). Simultaneous with the issuance of the New Watson Note, each of the Lead 2004 Investors and the other investors in the 2004 Debentures as of February 10, 2004 (collectively, the "Watson Note Purchasers") purchased the New Watson Note from Watson in consideration for a payment to Watson of $1.0 million.

In addition to Watson's forgiveness of approximately $16.4 million under the Watson Notes, as additional consideration for the Company's payment to Watson of approximately $4.3 million and the Company's conveyance of certain Company assets, all supply agreements between the Company and Watson were terminated and Watson waived the dilution protections contained in the Common Stock purchase warrant dated December 20, 2002 exercisable for approximately 10.7 million shares of the Company's Common Stock previously issued by the Company to Watson, to the extent such dilution protections were triggered by the transactions provided in the 2004 Debenture Offering.

Terms of the New Watson Note

The New Watson Note in the principal amount of $5.0 million as purchased by the Watson Note Purchasers is secured by a first lien on all of the Company's and its subsidiaries' assets, senior to the lien securing the Outstanding Debentures and all other Company indebtedness, carries a floating rate of interest equal to the prime rate plus 4.5% and matures on June 30, 2007.

Net Proceeds from the 2004 Debenture Offering

After giving effect to the payment to Watson of approximately $4.3 million to restructure the Watson Term Loan and the payment of legal and other professional fees relating to the 2004 Debenture Offering, the Company realized net proceeds from the 2004 Debenture Offering of approximately $7.3 million (the "2004 Debenture Offering Proceeds").

Sale of Certain Company Assets to Mutual

On February 18, 2004, the Company and Mutual Pharmaceutical Company, Inc. ("Mutual") entered into a certain Asset Purchase Agreement (the "Mutual Asset Purchase Agreement"). Pursuant to the terms of the Mutual Asset Purchase Agreement, the Company sold certain inactive, non-revenue generating ANDAs to Mutual in consideration of $2.0 million. The ANDAs sold to Mutual are set forth below.

THERAPEUTIC CATEGORY	APPROXIMATE NUMBER OF ANDAS
Analgesic	29
Anti-Infective	14
Antihypertensive/Cardiac	32
Antihistamine	6
Steroid	12
Cough & Cold	7
Central Nervous System	42
Other	10

The Company's decision to divest the above generic product ANDAs was based on (i) the Company's revised business strategy which focuses on research and development of novel and proprietary abuse deterrent formulation technology and opioid active pharmaceutical ingredient synthesis technologies, (ii) the Company had ceased operations at its finished dosage generic product manufacturing and packaging facilities and was in the process of negotiating for the sale of such facilities and (iii) these ANDAs were inactive, non revenue producing generic product ANDAs which had never been qualified for manufacturing or commercial distribution in the Company's Congers, NY generic product manufacturing facilities. These ANDAs were therefore not deemed to be operating assets of the Company.

Sale of Certain Company Assets to IVAX

On March 19, 2004, the Company and its wholly-owned subsidiary, Axiom Pharmaceutical Corporation, entered into an Asset Purchase Agreement with IVAX Pharmaceuticals New York LLC ("IVAX"). Pursuant to the Purchase Agreement, the Company and Axiom agreed to sell to IVAX substantially all of the Company's assets used in the operation of the Company's former generic manufacturing and packaging operations located in Congers, New York in consideration of an immediate payment of $2.0 million and an additional payment $0.5 million upon receipt of shareholder approval of the transaction to be sought at the Company's annual meeting of shareholders to be held on August 12, 2004. Pending Shareholder approval, the Company has recorded the initial payment of $2.0 million as a short term liability.

After giving effect to the payment of legal and other professional fees relating to the divestment of the ANDAs to Mutual and the proposed divestment of certain assets to IVAX, the Company estimates that it will realize aggregate net proceeds from such transactions of approximately $4.3 million. (the "Asset Divestment Proceeds").

ADF Technology Research and Development

The Company's primary business focus is the research and development of proprietary abuse deterrent formulation technologies (the "ADF Technology") intended to deter the abuse of opioid containing orally administered prescription products. The ADF technology has been tested in a variety of non-clinical settings and a patent application was filed with the United States Patent and Trademarks Office in the fourth quarter of 2003 (see discussion below under the caption "Patent Applications"). The Company's first product candidate ("ADF Product Candidate #1") resulting from the ADF Technology is a tablet formulation intended for oral administration. ADF Product Candidate #1 is currently undergoing required drug product stability testing prior to regulatory submission. To date the Company can provide no assurances that the stability of ADF Product Candidate #1 will result in a commercially acceptable drug product. In addition, ADF Product Candidate #1 is also currently under evaluation in a clinical study to assess the bio-availability of such product candidate in comparison to a frequently prescribed commercially marketed drug product with the same opioid active ingredient but without abuse deterrent properties. The final results from such clinical study are expected to be available in the second half of 2004. There can be no assurances that ADF Product Candidate #1 will be bio-available or bioequivalent to the extent required to justify continued clinical testing. To receive marketing authorization for commercial distribution in the United States, all drug products formulated with the ADF Technology will require the development, submission and filing of a new drug application ("NDA") and approval of such application by the U.S. Food and Drug Administration (the "FDA"). In the event that ADF Product Candidate #1 is stable and demonstrates acceptable bio-availability, then substantial additional clinical and non-clinical testing will be required prior to the submission of an NDA. There can be no assurances that ADF Product Candidate #1 will lead to an NDA submission or that if an NDA is filed, that the FDA will approve such regulatory application for commercial distribution.

Opioid Synthesis Technology Research and Development

The Company is also engaged in the research, development and scale-up of a variety of proprietary manufacturing processes for opioid active pharmaceutical ingredients (the "Opioid Synthesis Technologies") as generally described in the table below.

OPIOID SYNTHESIS TECHNOLOGY	STARTING MATERIAL	ESTIMATED YIELD	APPLICABLE DEA REGISTRATIONS REQUIRED	STATUS OF PATENT APPLICATION
Oxycodone HCl	Codeine Phosphate	40 - 50%	a) Research	One (1) Notice of Allowance issued
Process #1			b) Manufacturing	One (1) other Patent Pending before the PTO
Hydrocodone Bitartrate	Codeine Phosphate	85%	a) Manufacturing	Patent Application filed in the second quarter of 2004
Process #1				
Oxycodone HCl	NRMs	68 - 72%	a) Research	Patent Application filed in July 2004
Process #2			b) Manufacturing	
			c) Import	
Codeine Phosphate	NRMs	90 - 100%	a) Research	Patent Application filed in the second quarter of 2004
Process #1			b) Manufacturing	
			c) Import	
Codeine Phosphate	NRMs	80-90%	a) Research	Patent Application filed in the second quarter of 2004
Process #2			b) Manufacturing	
			c) Import	
Codeine Phosphate	NRMs	65-85%	a) Research	Patent Application filed in the fourth quarter of 2003
Process #3			b) Manufacturing	
			c) Import	
Hydrocodone Bitartrate	Codeine Base	85 - 95%	a) Research	Patent Application filed in the second quarter of 2004
Process #2			b) Manufacturing	
Morphine Sulfate	NRMs	96%	a) Research	Patent Application expected to be filed by the second quarter of 2005
			b) Manufacturing	
			c) Import	
Dihydrocodeine Bitartrate	Codeine Base	>90%	a) Research	Patent Application filed in the second quarter of 2004
			b) Manufacturing	

The Company believes at this stage of development that, except for oxycodone hydrochloride process #1, the Opioid Synthesis Technologies are efficient and cost-effective methods of manufacturing opioid APIs. The Company believes that the primary advantages of these processes include a substantial reduction in the time and number of processing steps required to produce the desired opioid APIs and reduction of the quantity and/or toxicity of the waste products relating to such production. The Company believes that at the current manufacturing scale Hydrocodone Bitartrate Process #1 meets all USP release testing specifications, provides high yields and high levels of purity compared to competitive manufacturing processes used for this active ingredient. The development and documentation of Hydrocodone Process #1 has been completed and the Company believes such process is ready to be tested at full commercial scale. Until such time, if any, as the Company secures third-party financing dedicated to scale-up expenses (as defined below under the caption "Hydrocodone Bitartrate Option Agreement") the Company will be unable to complete the commercial scale-up of the Hydrocodone Bitartrate Process #1 or the other Opioid Synthesis Technologies in the above table. No assurance can be given that the Company will obtain the third-party financing necessary to scale-up the Opioid Synthesis Technologies or that if such financing is obtained, that any one or more of the Opioid Synthesis Technologies will be capable of commercial scale-up.

Patent Applications

To date, the Company has filed seven (7) patents applications with the United States Patent and Trademark Office ("PTO") and one (1) foreign application relating to the Opioid Synthesis Technologies including two (2) in June 2003, one (1) in October 2003 and four (4) in May 2004 and one (1) patent application relating to the ADF Technology in the fourth quarter of 2003. The typical review time of a U.S. patent application varies. The initial review generally occurs approximately 12 to 18 months from date of patent filing. At the completion of the initial review, the patent examiner will issue an Office Action letter, which will detail any necessary amendments, supplements or reasons for the rejection. Subsequent processing of the patent application will depend on the number of Office Action letters issued and the speed of review of the Company's responses thereto. If an application is granted, a Notice of Allowance will be issued, requiring a payment of the issue fee within three (3) months from the date of the notice. Upon the payment of the fee, the patent would be issued.

In March 2004 the Company received a notice of allowance from the PTO relating to one of the patent applications filed in June of 2003. The Company has paid the issue fee and expects a U.S. patent will be granted from that application. No assurance can be given, however, that any other currently pending patent applications or future patent applications relating to the Opioid Synthesis Technologies will be granted. In addition, the Company is currently unable to provide any assurance that the U.S. patent application associated with the ADF Technology will issue, or if such patent issues, that the claims granted will be sufficiently broad to provide economic value.

Import License Registration

To provide for an economical source of raw materials for the commercial manufacture of opioids utilizing certain of the Opioid Synthesis Technologies, the Company filed with the U.S. Drug Enforcement Agency (the "DEA") an application for registration to import certain narcotic raw materials ("NRMs"). The Company filed its application for registration to import NRMs on January 31, 2001 (the "Import Registration"). Notice of the Company's application was published in the Federal Register on September 6, 2001. Within the 30 day period provided under DEA guidelines, three parties, including two companies that the Company believes are the largest U.S. importers of NRMs requested a hearing to formally object to the Company's request for an Import Registration. Pursuant to established procedures, an evidentiary hearing relating to the Company's Import Registration application was held before a DEA Administrative Law Judge ("ALJ") in August 2003. The ALJ later re-opened the administrative record, at the request of opposing parties, to consider the Company's November and December 2003 announcements concerning the Company restructuring and financing activities. After submission of additional testimony by the Company and certain of the opposing parties, the ALJ closed the evidentiary record effective May 25, 2004. Additionally, as of August 3, 2004, the Company and the opposing parties prepared and submitted briefing documents to the ALJ based on the evidentiary record. With the evidentiary record now closed, the ALJ will make findings of fact, draw legal conclusions and recommend a specific decision on the Company's Import Registration application to the DEA and issue a final order relating to the Company's application. Following the decision of the ALJ, the DEA will judge whether the issuance of an Import Registration is appropriate. Assuming DEA grants the Company's application, of which no assurance can be given, the Company would be permitted to import NRMs upon appropriate notice in the Federal Register. The opposing parties may challenge the DEA decision to grant the Company's application in an appropriate Court of Appeals. In such a case, assuming the Company opposes an appellate challenge, the Company would likely incur additional time delays and legal expenses prior to the issuance of a final decision by the U.S. Court of Appeals. Provided the Company continues to seek the Import Registration, the proceedings will continue through 2004 and beyond.

No assurance can be given that the Company's Import Registration application will be approved by the DEA or that if granted by DEA, the Import Registration would be upheld following an appellate challenge. Furthermore, the Company's cash flow and limited sources of available financing make it uncertain that the Company will have sufficient capital to continue to fund the development of the Opioid Synthesis Technologies, to obtain required DEA approvals and to fund the capital improvements necessary for the manufacture of APIs and finished dosage products incorporating the Opioid Synthesis Technologies.

Hydrocodone Bitartrate Option Agreement

The Company estimates that to scale up its Hydrocodone Bitartrate Process #1 Opioid Synthesis Technology to desirable commercial scale at its Culver Facility, additional funding of approximately $7.0 million will be required for facility improvements, the purchase, installation and validation of new API manufacturing equipment, environmental waste management compliance, the preparation of the drug master files for the API to be produced at the facility, and related direct labor expense (collectively, the "API Scale Up Expenses"). The Company is a party to a certain Hydrocodone Option Agreement dated February 6, 2004 with Watson Pharmaceuticals ("Watson") pursuant to which the Company has granted Watson a six (6) month exclusive option (the "Hydrocodone Option") to enter into a supply agreement with the Company for supply of hydrocodone bitartrate API (the "Hydrocodone API"). If such option is exercised by Watson, at Watson's sole discretion, of which there can be no assurance, Watson will fund 50% of the API Scale Up Expenses, up to a maximum of $3.5 million and the Company has agreed to use commercially reasonable efforts to obtain financing dedicated to fund its portion of the API Scale Up Expenses. In the event the Company is unable to secure financing dedicated to fund its portion of the API Scale Up Expenses, the Hydrocodone Option provides that the parties will discuss alternatives relating to the scale up of the its Opioid Synthesis Technology for Hydrocodone API. On August 4, 2004 the Hydrocodone Option Agreement with Watson expired unexercised.

As described in this Report, no portion of the 2004 Debenture Offering Proceeds or the Asset Divestment Proceeds is budgeted for the API Scale Up Expenses. Until such time, if any, as the Company secures third-party financing dedicated to the API Scale Up Expenses, the Company will be unable to complete the commercial scale up of its Opioid Synthesis Technologies.

Commercial Focus and Funding Requirements

The Company is committing substantially all of its resources and available capital to the development of the ADF Technology, Opioid Synthesis Technologies and to the prosecution of its Patent applications and the Import Registration. The failure of the Company to successfully develop the ADF Technology or to successfully obtain an issued U.S. patent relating to such technology will have a material adverse effect on the Company's operations and financial condition. The Company's cash flow and limited sources of available financing make it uncertain that the Company will have sufficient capital to continue to fund operations or to otherwise complete the development of the Opioid Synthesis and ADF Technologies, to obtain required DEA and FDA approvals, and to successfully prosecute its patent applications. The Company currently does not have the funds necessary to make the capital improvements required for the commercial scale manufacture of APIs and finished dosage products incorporating such technologies.

In view of the matters described above, recoverability of a major portion of the recorded asset amounts shown in the accompanying consolidated balance sheets is dependent upon continued operations of the Company, which in turn are dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain present financing, and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

NOTE 3 - NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Financial Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"), which addresses consolidation by business enterprises of variable interest entities (VIEs). In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in activities on behalf of another company. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN No. 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The accounting provisions and disclosure requirements of FIN No. 46 are effective immediately for VIEs created or acquired after January 31, 2003, and are effective for the Company's interim period ending March 31, 2004, for VIEs created prior to February 1, 2003. In December 2003, the FASB published a revision to FIN No. 46 ("FIN No. 46R") to clarify some of the provisions of the interpretation and to defer the effective date of implementation for certain entities. Under the guidance of FIN No. 46R, public companies that have interests in VIE's that are commonly referred to as special purpose entities are required to apply the provisions of FIN No. 46R for periods ending after December 15, 2003. A public company that does not have any interests in special purpose entities but does have a variable interest in a VIE created before February 1, 2003, must apply the provisions of FIN No. 46R by the end of the first interim or annual reporting period ending after March 14, 2004. During the quarter ended March 31, 2004 the Company adopted the provisions of FIN No. 46R. Adoption of FIN No. 46R did not have a material effect on the Company's financial statements. .

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," ("SFAS No. 149"), which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 except for the provisions that were cleared by the FASB in prior pronouncements. The adoption of SFAS No. 149 did not have a material impact on the Company's financial position or results of operations.

In May 2003, the FASB issued "SFAS No. 150", "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. In accordance with the standard, financial instruments that embody obligations for the issuer are required to be classified as liabilities. This Statement shall be effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position or results of operations.

Stock Based Compensation

The Company accounts for stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations ("APB No. 25") and has adopted the disclosure provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure, an amendment of FASB Statement No. 123." Under APB No. 25, when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Accordingly, no compensation expense has been recognized in the consolidated financial statements in connection with employee stock option grants.

The following table illustrates the effect on net income and earnings per share had the Company applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

	SIX MONTHS ENDED JUNE 30,	
	2004	2003
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Net loss, as reported	$ (16,432)	$ (21,602)
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards	(111)	(382)
Pro forma net income (loss)	$ (16,543)	$ (21,984)
Basic EPS -- as reported	$ (0.76)	$ (1.03)
Basic EPS -- pro forma	$ (0.77)	$ (1.05)
Diluted EPS -- as reported	$ (0.76)	$ (1.03)
Diluted EPS -- pro forma	$ (0.77)	$ (1.05)

Pro forma compensation expense may not be indicative of future disclosures because they do not take into effect pro forma compensation expense related to grants before 1995. For purposes of estimating the fair value of each option on the date of grant, the Company utilized the Black-Scholes option-pricing model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

NOTE 4 - RECLASSIFICATIONS

Certain reclassifications have been made to prior years' amounts to conform to current year's presentation.

NOTE 5 - EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average common shares outstanding during the period. Diluted earnings per share is based on the treasury stock method and is computed by dividing net income by the weighted average common shares and common share equivalents outstanding during the periods presented assuming the exercise of all in-the-money stock options. Common share equivalents have been excluded where their inclusion would be anti-dilutive. A reconciliation of the numerator and denominators of basic and diluted earnings per share for the six months ended June 30, 2004 and June 30, 2003 consisted of the following (in thousands except per share amount):

Six Months ended June 30,	2004	2003
Numerator:		
Net loss	$(16,432)	$(21,602)
Denominator:		
Basic weighted average shares outstanding	21,612	21,065
Convertible debentures	-	-
Warrants	-	-
Stock options	-	-
Diluted weighted average shares outstanding	21,612	21,065
Basic loss per share	$ (0.76)	$ (1.03)
Diluted loss per share	$ (0.76)	$ (1.03)

For the six months ended June 30, 2004 and June 30, 2003, approximately 340,547,000 and 224,500,000, respectively of outstanding warrants, options, and the effect of convertible debentures and convertible bridge loans outstanding, have been excluded from the computation of diluted earnings per share as they would be antidilutive to the reported net loss.

NOTE 6 - INVENTORIES

Inventories consist of the following:

	JUNE 30, 2004	DECEMBER 31, 2003
	(IN THOUSANDS)	
Finished Goods	$ 422	$ 357
Work in Process	188	953
Raw Materials	150	356
	760	1,666
Less impairment reserve	(760)	(1,354)
	$ -	$ 312

NOTE 7 - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	JUNE 30, 2004	DECEMBER 31, 2003
	(IN THOUSANDS)	
Payroll, Payroll Taxes and Benefits..................	$ 345	$ 468
Legal and Audit Fees.................................	195	519
Property and Sales Taxes.............................	147	142
Medicaid Rebates and Other Customer Allowances........	82	50
Benefit Plan Taxes...................................	200	200
Restructure Costs....................................	59	100
Investment Fees......................................	-	201
Director Fees..	-	45
Other	37	383
	$ 1,065	$ 2,108

NOTE 8 - CONVERTIBLE SUBORDINATED DEBENTURES

Convertible Subordinated Debentures consist of the following:

	JUNE 30, 2004	DECEMBER 31, 2003
	(IN THOUSANDS)	
1998 Debentures......................................	$ 31,212	$ 31,212
1999 Debentures......................................	21,485	21,485
2002 Debentures......................................	27,303	27,303
2003 Debentures......................................	6,632	6,632
2004 Debentures......................................	14,000	--
	100,632	86,632
Less: Debt discount..................................	(47,040)	(56,893)
	53,592	29,739
Less: Current maturities, net.........................	(11,207)	--
	$ 42,385	$ 29,739

Related-Party Transactions

A Company officer and Director of the Company holds certain of the 1998 Debentures and 1999 Debentures. The aggregate principal amount of such debentures was approximately $173,000 at June 30, 2004 and December 31, 2003. Interest expense on these debentures was approximately $4,400 and $9,200 for the six months ended June 30, 2004 and 2003, respectively, of which approximately $8,000 for the six-month period ended June 30, 2003 was paid through the issuance of like debentures. Interest expense on these debentures was approximately $2,200 and $4,600, for the three months ended June 30, 2004 and 2003, respectively, of which approximately $4,000 for the three month period ended June 30, 2003 was paid through the issuance of like debentures.

Indemnifications

Each of the purchase agreements for the Company's 1998 Debentures, 1999 Debentures, 2002 Debentures, 2003 Debentures and Bridge Loans, and 2004 Debentures contain provisions by which the Company is obligated to indemnify the purchasers of the debentures for any losses, claims, damages, liabilities, obligations, penalties, awards, judgments, expenses or disbursements arising out of or resulting from the breach of any representation, warranty or agreement of the Company related to the purchase of the debentures and bridge loans. These indemnification obligations do not include a limit on maximum potential future payments, nor are there any recourse provisions or collateral that may offset the cost. As of June 30, 2004, the Company does not believe that any liability has been incurred as a result of these indemnification obligations.

NOTE 9 - TERM NOTE PAYABLE

Terms of Watson Term Loan

In connection with various transactions between the Company and Watson completed in 2001, Watson advanced $17.5 million to the Company under the terms of a certain loan agreement by and between the Company and Watson ("Watson Term Loan"), dated as of March 29, 2000, as subsequently amended on each of March 31, 2000, December 20, 2002 and February 6, 2004. The Watson Term Loan was evidenced by a note in the principal amount of $17.5 million (the "Original Watson Note"). The Watson Term Loan was secured by a first lien on all of the Company's assets, senior to the lien securing all other Company indebtedness, and carried a floating rate of interest equal to prime plus two percent and had an original maturity date of June 30, 2004.

2002 Amendment to Watson Term Loan and Issuance of the Watson Warrant

As part of the Company's 2002 Debenture Offering, the Watson Term Loan was amended to (1) extend the maturity date to March 31, 2006, (2) increase the interest rate to prime plus four and one half percent and (3) increase the principal amount to approximately $21.4 million to reflect the inclusion of the Company's payment obligations under the Core Products Supply Agreement between Watson and the Company. As amended, the Watson Term Loan was evidenced by the Original Watson Note and an additional note in the principal amount of approximately $ 3.9 million (collectively, the "Watson Notes"). In consideration of the amendment to the Watson Term Loan, the Company issued to Watson a common stock purchase warrant ("Watson Warrant") exercisable for 10,700,665 shares of the Company's common stock at an exercise price of $0.34 per share. The warrant has a term expiring December 31, 2009. The fair value of the Watson Warrant on the date of grant, as calculated using the Black-Scholes option-pricing model, of $11,985,745 was charged to earnings on the date of grant as a loss on the extinguishment of debt. As of December 31, 2003, Watson had advanced approximately $21.4 million to the Company under the Watson Term Loan and the interest rate was 8.50%.

2004 Amendment to Watson Term Loan

In satisfaction of a condition to the completion of the 2004 Debenture Offering, simultaneous with the closing of the 2004 Purchase Agreement, the Watson Term Loan was further amended, as a result of which (1) the Company paid Watson the sum of approximately $4.3 million (which amount was funded from the proceeds of the 2004 Debenture Offering), (2) the Company conveyed to Watson certain Company assets in consideration for Watson's forgiveness of approximately $16.4 million of indebtedness under the Watson Notes, (3) all then-current supply agreements between the Company and Watson were terminated , (4) Watson waived the dilution protections contained in the Watson Warrant, to the extent such dilution protections were triggered by the transactions provided in the 2004 Debenture Offering and (5) the Watson Notes were consolidated into a single note in the principal amount of $5.0 million (the "New Watson Note"), which (i) bears interest at the rate equal to the prime rate plus four and one half percent (4.5%) per annum, (ii) has a maturity date of June 30, 2007 (extended from March 31, 2006), (iii) provides for satisfaction of future quarterly interest payments thereunder in the form of the Company's Common Stock, (iv) provides for the forbearance from the exercise of rights and remedies upon the occurrence of certain events of default thereunder and (v) is secured by a first lien on all assets of the Company. Further, the Company's obligations under the New Watson Note are guaranteed by Houba, Inc. and Axiom Pharmaceutical Corporation, each a wholly-owned subsidiary of the Company, which guarantees are secured by all assets of such subsidiary, and, in the case of Houba, Inc., by a mortgage lien on its real property located in Culver, Indiana.

Purchase of the New Watson Note

Simultaneous with the issuance of the New Watson Note, each of the Lead 2004 Investors and the other investors in the 2004 Debentures at the initial closing of the 2004 Purchase Agreement on February 10, 2004 (collectively, the "Watson Note Purchasers") purchased the New Watson Note from Watson in consideration for a payment to Watson of $1.0 million. The New Watson Note is secured by a first lien on all of the Company's and its subsidiaries' assets, senior to the lien securing the Outstanding Debentures and all other Company indebtedness, carries a floating rate of interest equal to the prime rate plus 4.5% and matures on June 30, 2007. The rate of interest at June 30, 2004 was 8.50%. Effective July 1, 2004, the interest rate became 8.75% as a result of the increase in the prime rate of interest.

NOTE 10 - INCOME TAXES

The Company has not provided for any tax expense during the six months ended June 30, 2004, as a result of utilizing net operating loss carry forwards not previously provided for. Historically, the Company has incurred significant losses from operations and until such time as the research and development efforts are commercialized, for which no assurance can be given, the Company will continue to incur operating losses.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

U.S. Department of Justice Settlement

On June 21, 1993, the Company entered into a Plea Agreement with the U.S. Department of Justice (the "DOJ") to resolve the DOJ's investigation into the manufacturing and record keeping practices of the Company's Brooklyn, New York plant. The Plea Agreement required the Company to pay a fine of $2,500,000 over five years in quarterly installments of $125,000, commencing on or about September 15, 1993.

As of February 28, 1998, the Company was in default of the payment terms of the Plea Agreement and had made payments aggregating $350,000. On May 8, 1998, the Company and the DOJ signed the Letter Agreement serving to amend the Plea Agreement relating to the terms of the Company's satisfaction of the fine assessed under the Plea Agreement (the "Letter Agreement"). Specifically, the Letter Agreement provided that the Company will satisfy the remaining $2,150,000 of the fine through the monthly payments of $25,000 commencing June 1, 1998, plus interest on such outstanding balance (at the rate calculated pursuant to 28 U.S.C. Section 1961 (5.319%)). Such payment schedule provides for the full satisfaction of the DOJ fine in July 2005. The Letter Agreement also provides certain restrictions on the payment of salary or compensation to any individual in excess of certain amounts without the written consent of the DOJ. In addition, the Letter Agreement requires the repayment of the outstanding fine to the extent of 25% of the Company's after-tax profit or 25% of the net proceeds received by the Company on any sale of a capital asset for a sum in excess of $10,000, if not invested in another capital asset. At December 31, 2003, the Company was current in its payment obligations, with a remaining obligation of $433,000. In February 2004, the Company fully satisfied its obligation to the DOJ under the Letter Agreement.

Employment Contracts

During April 2004, the Company entered into an employment agreement with a new officer/employee of the Company. The agreement provides for, among other things: (i) an annual base salary of $260,000, and (ii) an aggregate of 3,000,000 options to purchase the Company's stock at an exercise price of $0.13 per common share that vest 1,000,000 option shares on October 1, 2004 and the balance thereafter at a rate of 333,333 per calendar quarter, beginning January 1, 2005 with an exercise term expiring in ten years. The stock option is subject to the shareholders approval to modify the Company's 1998 Stock Option Plan to (i) increase the number of shares reserved for issuance and (ii) authorize issuance of stock options having an exercise price less than fair market value of the common stock of the Company on the date of issuance. The employment agreement term is for a two year period, which automatically renews for successive one-year periods unless either the Company or the employee provides 90 days' notice of non-renewal.

During August 2003, the Company entered into an employment agreement with a new officer/employee of the Company. The agreement provides for, among other things: (i) an annual base salary of $300,000, and (ii) the commitment to issue an aggregate of 5,500,000 options to purchase the Company's stock at an exercise price of $0.34 per common share that vest 1,000,000 option shares on March 31, 2004 and the balance thereafter at a rate of 500,000 per calendar quarter, beginning June 30, 2004 which an exercise term expiring in ten years. The stock option is subject to the shareholders approval to modify the Company's 1998 Stock Option Plan to (i) increase the number of shares reserved for issuance and (ii) authorize issuance of stock options having an exercise price less than fair market value of the common stock of the Company on the date of issuance. The employment agreement term is for a two year period, which automatically renews for successive one-year periods unless either the Company or the employee provides 90 days' notice of non-renewal. In May 2004, such employment agreement was amended, among other things, to adjust the Company's commitment to issue stock options from 5,500,000 shares to 8,750,000 shares and to provide for an exercise price of $0.13 per share. Upon grant, the option will have a ten-year term and will provide for vesting in the amount of 2,750,000 shares on June 30, 2004 and the balance thereafter at a rate of 250,000 shares per calendar month, beginning July 31, 2004.

During April 2004, the Company committed to issue to current employees stock options that upon grant, will be exercisable for an aggregate of 1,425,000 shares of the Company's common stock at an exercise price of $0.13 per common share and will vest 25% annually over four years and provide for immediate vesting upon change of control. The grant of these stock options is subject to the shareholders approval to modify the Company's 1998 Stock Option Plan to (i) increase the number of shares reserved for issuance and (ii) authorize issuance of stock options having an exercise price less than fair market value of the common stock of the Company on the date of issuance.

Stock Option Grants to Board Members

On June 26, 2004, the Company committed to issue to the members of its board of directors, including the Independent Committee of the Board, stock options that upon grant or complete vesting, will be exercisable for an aggregate of 1,100,000 shares of the Company's common stock at an exercise price equal to the fair market value of the Company's Common Stock on the date of grant. With the exception of stock options to purchase an aggregate of 200,000 shares of the Company's Common Stock, all options are fully vested at the time of grant. Options to purchase an aggregate of 200,000 shares of the Company's Common Stock will vest 25% quarterly over one year. The grant of all stock options is subject to the shareholders approval to modify the Company's 1998 Stock Option Plan.

Legal Proceedings

Beginning in 1992, actions were commenced against the Company and numerous other pharmaceutical manufacturers in connection with the alleged exposure to diethylstilbestrol ("DES"). The defense of all of such matters was assumed by the Company's insurance carrier and a substantial number have been settled by the carrier. Currently, several actions remain pending with the Company as a defendant and the insurance carrier is defending each action. Plaintiffs in the pending litigations seek unspecified damages. The Company does not believe any of such actions will have a material impact on the Company's financial condition. The ultimate outcome of these lawsuits cannot be determined at this time, and accordingly, no adjustment has been made to the consolidated financial statements.

The Company is named as a defendant in an action entitled Alfred Kohn v. Halsey Drug Co. in the Supreme Court of New York, Bronx County. The plaintiff seeks damages of $1.0 million for breach of an alleged oral contract to pay a finder's fee for a business transaction involving the Company. Discovery in this action is complete. The Company's motion for summary judgment was due to be heard by the Court on August 8, 2003. Plaintiff Kohn deceased shortly prior to such hearing date, and the motion for summary judgment and any trial of this matter have been stayed pending the substitution of Mr. Kohn's estate as the plaintiff. The Company does not believe this action will have a material impact on the Company's financial condition. The ultimate outcome of this lawsuit cannot be determined at this time, and accordingly, no adjustment has been made to the consolidated financial statements.

On June 13, 2002, the Company was named an additional defendant in an Amended Complaint filed in the matter entitled Vintage Pharmaceuticals, Inc., v. Watson Pharmaceuticals, Inc., and Halsey Drug Company, Inc., pending in the United States District Court for the Northern District of Alabama, Civil Action No. CV 01-B-1847-NE. Vintage seeks unspecified damages from the Company for allegedly interfering with Vintage's contract to produce Monodox(R), the brand name of doxycycline monohydrate, for Watson. During the first quarter of 2004, Watson's motion for summary judgment was approved by the Court and the case was dismissed against Watson. On May 4, 2004, the Court issued an order in favor of the Company dismissing the case with prejudice. On May 14, 2004, Vintage filed for appeal of each of these rulings. The Company does not believe such action will have a material impact on the Company's financial condition. The ultimate outcome of this lawsuit cannot be determined at this time, and accordingly, no adjustment has been made to the consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003

NET PRODUCT REVENUES

The Company's net product revenues for the six months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

6/30/04 NET PRODUCT REVENUES	6/30/03 NET PRODUCT REVENUES	6/30/04-6/30/03 NET PRODUCT REVENUE CHANGE ($)	6/30/04-6/30/03 NET PRODUCT REVENUE CHANGE (%)
$ 838	$ 2,732	($ 1,894)	(69%)

The decrease in net product revenues was primarily a result of the Company's decision to restructure operations and cease the manufacture of finished dosage generic pharmaceutical products. The net product revenues in the second quarter of 2004 reflect the sale of all remaining inventories of saleable finished dosage generic pharmaceutical products.

COST OF MANUFACTURING

The Company's cost of manufacturing for the six months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

6/30/04 COST OF MANUFACTURING	6/30/03 COST OF MANUFACTURING	6/30/04-6/30/03 COST OF MANUFACTURING CHANGE ($)	6/30/04-6/30/03 COST OF MANUFACTURING CHANGE (%)
$ 1,437	$ 5,138	($ 3,701)	(72%)

For the six months ending 6/30/04 cost of manufacturing includes fixed costs of the Company's generic finished dosage manufacturing operations in the first quarter of 2004. The generic finished dosage manufacturing operations were discontinued in March, 2004.

RESEARCH AND DEVELOPMENT EXPENSES

The Company's research and development expenses for the six months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

6/30/04 R&D EXPENSES	6/30/03 R&D EXPENSES	6/30/04-6/30/03 R&D EXPENSES CHANGE ($)	6/30/04-6/30/03 R&D EXPENSES CHANGE (%)
$ 1,242	$ 616	$ 626	102%

The increase in R&D expenses is primarily related to the Company's strategic decision to devote a major portion of its resources in 2004 to research and development activities relating to its ADF Technologies and to a lessor extent to its Opioid Synthesis Technologies.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the six months ended June 30, 2004 and 2003 were as follows (in thousands):

6/30/04 S, G&A EXPENSES	6/30/03 S, G&A EXPENSES	6/30/04-6/30/03 S, G&A EXPENSES CHANGE ($)	6/30/04-6/30/03 S, G&A EXPENSES CHANGE (%)
$ 2,363	$ 3,917	($ 1,554)	(40%)

The decrease is due primarily to a reduction in sales and marketing expenses of $33, reduced general and administrative expenses of $477, and reduced payroll and payroll related expenses of $852 resulting from the Company's decision to discontinue the marketing and sale of generic finished dosage products and reduce administrative staff, as well as a $192 benefit for settlement of trade payables at a discount.

ENVIRONMENTAL COMPLIANCE EXPENSES

During the six months ended June 30, 2004 and June 30, 2003, the Company incurred the following expenses in connection with environmental compliance (in thousands):

6/30/04 ENVIRONMENTAL COMPLIANCE EXPENSES	6/30/03 ENVIRONMENTAL COMPLIANCE EXPENSES	6/30/04-6/30/03 ENVIRONMENTAL COMPLIANCE EXPENSES CHANGE ($)	6/30/04-6/30/03 ENVIRONMENTAL COMPLIANCE EXPENSES CHANGE (%)
$ 180	$ 121	$ 59	49%

The environmental compliance expenses relate primarily to disposal of hazardous and controlled substances waste and related personnel costs for environmental compliance.

INTEREST EXPENSE, NET OF INTEREST INCOME

The Company's interest expense, net of interest income for the six months ended June 30, 2004 and June 30, 2003 was as follows (in thousands):

6/30/04 INTEREST EXPENSE, NET OF INTEREST INCOME	6/30/03 INTEREST EXPENSE, NET OF INTEREST INCOME	6/30/04-6/30/03 INTEREST EXPENSE, NET OF INTEREST INCOME CHANGE ($)	6/30/04-6/30/03 INTEREST EXPENSE, NET OF INTEREST INCOME CHANGE (%)
$ 2,130	$ 2,883	($ 753)	(26%)

The change in the interest expense, net of interest income reflects the interest savings from the restructuring of the Company's term note indebtedness to Watson Pharmaceuticals.

AMORTIZATION OF DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS

The Company's deferred debt discount and private offering costs for the six months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

6/30/04 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS	6/30/03 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS	6/30/04-6/30/03 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS CHANGE ($)	6/30/04-6/30/03 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS CHANGE (%)
$ 24,655, consisting of - $ 234 private offering costs - $ 24,421 deferred debt discount	$ 11,683, consisting of - $ 306 private offering costs - $ 11,377 deferred debt discount	$ 12,972	111%

The change in the deferred debt discount and private offering costs of the Company reflects the additional amortization of the debt discount incurred from the Company's 2004 financings.

NET LOSS

The Company's net loss for the six months ended June 30, 2004 and June 30, 2003 was as follows (in thousands):

6/30/04 NET LOSS	6/30/03 NET LOSS	6/30/04-6/30/03 NET LOSS CHANGE ($)	6/30/04-6/30/03 NET LOSS CHANGE (%)
($ 16,432)	($ 21,602)	($ 5,170)	(24%)

Included in the net loss for the six months ending 6/30/04 are gains on debt restructuring of $12,401 and asset sales of $1,755 and other income of $401 relating to settlement of a liability at a discount.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2004 AND 2003

NET PRODUCT REVENUES

The Company's net product revenues for the three months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

3 MONTHS ENDED 6/30/04 NET PRODUCT REVENUES	3 MONTHS ENDED 6/30/03 NET PRODUCT REVENUES	3 MONTHS ENDED 6/30/04- 6/30/03 NET PRODUCT REVENUE CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 NET PRODUCT REVENUE CHANGE (%)
$ 210	$ 1,206	($ 996)	(83%)

The decrease in net product revenues was primarily a result of the Company's decision to restructure operations and cease the manufacture of finished dosage generic pharmaceutical products. The net product revenues in the second quarter of 2004 reflect the sale of all remaining inventories of saleable finished dosage products.

COST OF MANUFACTURING

The Company's cost of manufacturing for the three months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

3 MONTHS ENDED 6/30/04 COST OF MANUFACTURING	3 MONTHS ENDED 6/30/03 COST OF MANUFACTURING	3 MONTHS ENDED 6/30/04-6/30/03 COST OF MANUFACTURING CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 COST OF MANUFACTURING CHANGE (%)
$ 184	$ 2,265	($ 2,081)	(92%)

For the three months ending 6/30/04 cost of manufacturing includes residual fixed costs of associated with the Company's generic finished dosage manufacturing operations in the first quarter of 2004. The generic finished dosage manufacturing operations were discontinued in March, 2004.

RESEARCH AND DEVELOPMENT EXPENSES

The Company's research and development expenses for the three months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

3 MONTHS ENDED 6/30/04 R&D EXPENSES	3 MONTHS ENDED 6/30/03 R&D EXPENSES	3 MONTHS ENDED 6/30/04-6/30/03 R&D EXPENSES CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 R&D EXPENSES CHANGE (%)
$ 1,004	$ 287	$ 717	250%

The increase in R&D expenses is primarily related to the Company' strategic decision to devote a large portion of its resources in 2004 to research and development activities relating to its ADF Technologies and to a lessor extent to its Opioid Synthesis Technologies.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the three months ended June 30, 2004 and 2003 were as follows (in thousands):

3 MONTHS ENDED 6/30/04 S, G&A EXPENSES	3 MONTHS ENDED 6/30/03 S, G&A EXPENSES	3 MONTHS ENDED 6/30/04-6/30/03 S, G&A EXPENSES CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 S, G&A EXPENSES CHANGE (%)
$ 1,142	$ 2,206	($ 1,064)	(48%)

The decrease is due primarily to a reduction in sales and marketing expenses of $42, reduced general and administrative expenses of $239, and reduced payroll and payroll related expenses of $783 resulting from the Company's decision in the fourth quarter of 2003 to eliminate the sale of generic finished dosage products and reduce administrative staff.

ENVIRONMENTAL COMPLIANCE EXPENSES

During the three months ended June 30, 2004 and June 30, 2003, the Company incurred the following expenses in connection with environmental compliance (in thousands):

3 MONTHS ENDED 6/30/04 ENVIRONMENTAL COMPLIANCE EXPENSES	3 MONTHS ENDED 6/30/03 ENVIRONMENTAL COMPLIANCE EXPENSES	3 MONTHS ENDED 6/30/04-6/30/03 ENVIRONMENTAL COMPLIANCE EXPENSES CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 ENVIRONMENTAL COMPLIANCE EXPENSES CHANGE (%)
$ 83	$ 36	$ 47	131%

The environmental compliance expenses relate to disposal of hazardous and controlled substances waste and related personnel costs for environmental compliance...

INTEREST EXPENSE, NET OF INTEREST INCOME

The Company's interest expense, net of interest income for the three months ended June 30, 2004 and June 30, 2003 was as follows (in thousands):

3 MONTHS ENDED 6/30/04 INTEREST EXPENSE, NET OF INTEREST INCOME	3 MONTHS ENDED 6/30/03 INTEREST EXPENSE, NET OF INTEREST INCOME	3 MONTHS ENDED 6/30/04-6/30/03 INTEREST EXPENSE, NET OF INTEREST INCOME CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 INTEREST EXPENSE, NET OF INTEREST INCOME CHANGE (%)
$ 1,179	$ 1,467	($ 288)	(20%)

The change in the interest expense, net of interest income reflects the interest savings from the restructuring of the Company's term note indebtedness to Watson Pharmaceuticals.

AMORTIZATION OF DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS

The Company's deferred debt discount and private offering costs or the three months ended June 30, 2004 and June 30, 2003 were as follows (in thousands):

3 MONTHS ENDED 6/30/04 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS	3 MONTHS ENDED 6/30/03 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS	3 MONTHS ENDED 6/30/04-6/30/03 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 DEFERRED DEBT DISCOUNT AND PRIVATE OFFERING COSTS CHANGE (%)
$ 13,812, consisting of - $ 136 private offering costs - $ 13,676 deferred debt discount	$ 5,916, consisting of - $ 228 private offering costs - $ 5,688 deferred debt discount	$ 7,896	134%

The change in the deferred debt discount and private offering costs of the Company reflects the amortization of the debt discount incurred from the Company's 2004 financings.

NET LOSS

The Company's net loss for the three months ended June 30, 2004 and June 30, 2003 was as follows (in thousands):

3 MONTHS ENDED 6/30/04 NET LOSS	3 MONTHS ENDED 6/30/03 NET LOSS	3 MONTHS ENDED 6/30/04-6/30/03 NET LOSS CHANGE ($)	3 MONTHS ENDED 6/30/04-6/30/03 NET ILOSS CHANGE (%)
($ 17,112)	($ 11,027)	$ 6,085	55%

Included in the net loss for the 3 months ending 6/30/04 is a gain on asset sales of $1 and other expenses of $2.

LIQUIDITY AND CAPITAL RESOURCES

Overview

In November 2003, the Company commenced the restructuring of its operations to focus its efforts on research and development relating to certain proprietary technologies and to provide for the cessation of operations, and the sale of assets, relating to the manufacture and distribution of finished dosage generic products conducted at the Company's Congers, New York facilities (the "Congers Facilities").

In order to fund continuing operations and the research and development of the Company's proprietary technologies, on February 6, 2004, the Company completed a private offering of debentures in the aggregate principal amount of approximately $12.3 million (the "2004 Debenture Offering"). As part of the completion of the 2004 Debenture Offering, the Company retired approximately $16.4 million in indebtedness under the Company's $21.4 million term loan with Watson Pharmaceuticals.

On April 14, 2004 and May 26, 2004 the Company completed additional funding under the 2004 Debenture Offering in the principal amount of approximately $1.7 million resulting in the aggregate principal amount of convertible secured debentures issued as part of the 2004 Debenture Offering of $14.0 million.

Additionally, on February 18, 2004 and March 19, 2004, the Company contracted for the sale of certain of its assets. Specifically, on February 18, 2004, the Company sold certain of its inactive, non-revenue generating ANDAs to Mutual Pharmaceutical Company, Inc. in consideration of $2.0 million. On March 19, 2004, the Company and its wholly-owned subsidiary, Axiom Pharmaceutical Corporation, entered into an Asset Purchase Agreement with IVAX Pharmaceuticals New York LLC ("IVAX") pursuant to which the Company and Axiom agreed to sell to IVAX substantially all of the Company's assets used in the operation of the Congers Facilities in consideration of $2.5 million.

Company's Present Financial Condition and Commercial Focus

At June 30, 2004 the Company had cash and cash equivalents of $6,583,000 as compared to $942,000 at December 31, 2003. The Company had a working capital deficit of $10,978,000 at June 30, 2004 and a working capital deficit of $3,770,000 at December 31, 2003. The Company had an accumulated deficit of $225,977,000 and $209,545,000 as June 30, 2004 and December 31, 2003, respectively. The Company had an operating loss of $4,204,000 for the six months ended June 30, 2004.

In implementing the restructuring adopted by the Board, the Company has transitioned to a single vertically integrated operations facility located in Culver, Indiana. The Company's strategy and key activities to be conducted at the Culver Facility are as follows:

- Development of the Company's ADF Technology for use in orally administered opioid finished dosage product candidates.

- Manufacture and quality assurance release of clinical trial supplies of certain finished dosage form product candidates utilizing the ADF Technology.

- Evaluation of certain finished dosage product candidates utilizing the ADF Technology in clinical trials.

- Scale-up and manufacture of commercial quantities of certain product candidates utilizing the ADF Technology for sale by the Company's licensees.

- Research, development and scale up of the Company's Opioid Synthesis Technologies.

- Prosecution of the Company's application to the DEA to for registration to import NRMs for use in the production of opioid API's utilizing the Company's Opioid Synthesis Technologies.

- Negotiating and executing license and development agreements with strategic pharmaceutical company partners providing that such licensees will further develop certain finished dosage product candidates utilizing the ADF Technology, file for regulatory approval with the FDA and other regulatory authorities and commercialize such products.

2004 Debenture Offering

On February 10, 2004, the Company consummated a private offering of convertible senior secured debentures (the "2004 Debentures") in the aggregate principal amount of approximately $12.3 million (the "2004 Debenture Offering"). The 2004 Debentures were issued by the Company pursuant to a certain Debenture and Share Purchase Agreement dated as of February 6, 2004 (the "2004 Purchase Agreement") by and among the Company, Care Capital, Essex, Galen and each of the purchasers listed on the signature page thereto. As the conversion price of such debentures was less than the fair market value of the Company's common stock on the date of issue, beneficial conversion features were determined to exist. The Company recorded approximately $12.3 million of debt discount limited to the face amount of the new debt, which is being amortized over the life of the debt, which matures July 31, 2004, subject to automatic extension up to October 31, 2004 to allow for the completion of the Company's 2004 Annual Meeting of Shareholders. During the six months ended June 30, 2004, the Company recognized approximately $3.8 million of amortization expense from this transaction.

Additional Funding under 2004 Debenture Offering

On April 14, 2004, the Company completed an additional closing under the 2004 Purchase Agreement pursuant to which the Company issued additional 2004 Debentures in the aggregate principal amount of approximately $0.6 million, bringing the aggregate principal amount of 2004 Debentures issued by the Company under the 2004 Purchase Agreement to $12.9 million. As the conversion price of such debentures was less than the fair market value of the Company's common stock on the date of issue, beneficial conversion features were determined to exist. The Company recorded approximately $0.6 million of debt discount limited to the face amount of the new debt, which will be amortized over the life of the debt, which matures July 31, 2004, subject to automatic extension up to October 31, 2004 to allow for the completion of the Company's 2004 Annual Meeting of Shareholders.

On May 26, 2004, the Company completed an additional closing under the 2004 Purchase Agreement pursuant to which the Company issued additional 2004 Debentures in the aggregate principal amount of approximately $1.1 million, bringing the aggregate principal amount of 2004 Debentures issued by the Company under the 2004 Purchase Agreement to $14.0 million. As the conversion of such debentures was less than the fair market value of the Company's common stock on the date of issue, beneficial conversion features were determined to exist. The Company recorded approximately $1.1 million of debt discount limited to the face amount of the new debt, which will be amortized over the life of the debt, which matures July 31, 2004, subject to automatic extension up to October 31, 2004 to allow for the completion of the Company's 2004 Annual Meeting of Shareholders.

Source and Amount of Funding under 2004 Purchase Agreement

Of the $14.0 million in 2004 Debentures issued in the 2004 Debenture Offering, approximately $2.0 million of 2004 Debentures were issued in exchange for the surrender of like amount of principal plus accrued interest outstanding under Company's 5% convertible senior secured debentures issued pursuant to working capital bridge loan transactions with Care Capital, Essex and Galen during November and December, 2003.

Amendment to 2004 Purchase Agreement

The 2004 Purchase Agreement provided for the issuance by the Company of convertible senior secured debentures in the aggregate principal amount of $14.0 million to be completed no later than June 5, 2004. On June 1, 2004, an Amendment to the 2004 Purchase Agreement was executed providing for (i) an increase the principal amount of debentures issuable by the Company under the 2004 Purchase Agreement from $14.0 million to $17.5 million, and (ii) an extension of the time to complete this additional financing from June 5, 2004 to June 30, 2004 (the "2004 Purchase Agreement Amendment"). No additional 2004 Debentures were issued following the 2004 Purchase Agreement Amendment.

Terms of 2004 Debentures

The 2004 Debentures, issued at par, bear interest at the rate of 1.62% per annum, the short-term Applicable Federal Rate on February 6, 2004. The 2004 Debentures are secured by a lien on all assets of the Company. In addition, each of Houba, Inc. and Axiom Pharmaceutical Corporation, each a wholly-owned subsidiary of the Company, has executed in favor of the 2004 Debenture holders, an unconditional agreement of guaranty of the Company's obligations under the 2004 Purchase Agreement. Each guaranty is secured by all assets of such subsidiaries. In addition, the Company has pledged the stock of each such subsidiary to the holders of the 2004 Debentures to further secure its obligations under the 2004 Purchase Agreement.

Subordination of Lien of Holders of 2004 Debentures to the Lien Under the Watson Term Loan Agreement

In accordance with the terms of an Amended and Restated Subordination Agreement dated as of February 6, 2004 between the Company, the holders of the 2004 Debentures and the holders of the Company's other outstanding debentures, the liens on the Company's and its subsidiary's assets as well as the payment priority of the 2004 Debentures are (i) subordinate to the Company's lien and payment obligations in favor of Watson Pharmaceuticals under the Watson Term Loan Agreement, and (ii) senior to the Company's lien and payment obligations in favor of the holders of the Company's other outstanding debentures in the aggregate principal amount of approximately $86.6 million.

Conversion of 2004 Debentures into Series A Preferred Stock

The 2004 Debentures (including the principal amount plus interest accrued at the date of conversion) will convert automatically into the Company's Series A convertible preferred stock (the "Series A Preferred") immediately following the Company's receipt of shareholder approval at its next shareholders' meeting to restate the Company's Certificate of Incorporation (the "Charter Amendment") to authorize the Series A Preferred and the Junior Preferred Shares (as described below) and the filing of the Charter Amendment with the Office of the New York Department of State (the date of such filing, the "Charter Amendment Filing Date"), as provided in the 2004 Purchase Agreement. The 2004 Debentures will convert into Series A Preferred at a price per share (the "Series A Conversion Price") of $0.6425, representing the average of the closing bid and asked prices of the Company's Common Stock for the twenty (20) trading days ending February 4, 2004, as reported by the Over-the-Counter ("OTC") Bulletin Board. The Series A Conversion Price is subject to adjustment, from time to time, to equal the consideration per share received by the Company for its Common Stock, or the conversion/exercise price per share of the Company's Common Stock issuable under rights or options for the purchase of, or stock or other securities convertible into, Common Stock ("Convertible Securities"), if lower than the then applicable Series A Conversion Price.

Based on the $0.6425 Series A Conversion Price of the Series A Shares and estimating the interest accrual under the 2004 Debentures prior to the Charter Amendment Filing Date, the 2004 Debentures with an aggregate principal amount of $14 million would be convertible into an aggregate of approximately 22 million Series A Preferred shares.

Series A Preferred Stock Liquidation Preference, Conversion Right and Participation Right

In general, the Series A Preferred shares have a liquidation preference equal to five (5) times the initial $0.6425 Series A Conversion Price (the "Series A Liquidation Preference"). In addition, the Series A Preferred shares are convertible into the Company's Common Stock, with each Series A Preferred share convertible into the number of shares of Common Stock obtained by dividing (i) the Series A Liquidation Preference, by (ii) the $0.6425 Series A Conversion Price, as such conversion price may be adjusted, from time to time, pursuant to the dilution protections of such shares. Without limiting the Series A Liquidation Preference, the holders of Series A Preferred shares also have the right to participate with the holders of the Company's Common Stock upon the occurrence of a liquidation event, including the Company's merger, sale of all or substantially all of its assets or a change of control transaction, on an as-converted basis (but for these purposes only, assuming the Series A Preferred shares to be convertible into only thirty percent (30%) of the shares of Common Stock into which they are otherwise then convertible). The holders of Series A Preferred shares also have the right to vote as part of a single class with all holders of the Company's voting securities on all matters to be voted on by such security holders. Each holder of Series A Preferred shares will have such number of votes as shall equal the number of votes he would have had if such holder converted all Series A Preferred shares held by such holder into shares of Common Stock immediately prior to the record date relating to such vote.

Nomination of Directors to the Company's Board of Directors by the Lead 2004 Investors

The 2004 Purchase Agreement provides that each of Care Capital, Essex and Galen (collectively, the "Lead 2004 Investors") has the right to designate for nomination one member of the Company's Board of Directors, and that the Lead Investors collectively may designate one additional member of the Board (collectively, the Designees"). The Purchase Agreement further provides that the Designees, if so requested by such Designee in his sole discretion, shall be appointed to the Company's Executive Committee, Compensation Committee and any other Committee of the Board of Directors. The Designees of Care Capital, Essex and Galen are Messrs. Karabelas, Thangaraj and Wesson, respectively, each of whom are current Board members. Effective as of the closing of the 2004 Purchase Agreement, the Lead 2004 Investors may collectively nominate one additional Designee to the Board. The Company has agreed to nominate and appoint to the Board of Directors, subject to shareholder approval, one designee of each of Care Capital, Essex and Galen, and one collective designee of the Lead 2004 Investors, for so long as each holds a minimum of 50% of the Series A Preferred shares initially issued to such party (or at least 50% of the shares of Common Stock issuable upon conversion of the Series A Preferred shares).

Impact of Conversion of the Company's Outstanding Debentures

As of February 6, 2004, the date of the initial closing of the 2004 Purchase Agreement, the Company had issued and outstanding and aggregate of approximately $86.6 million in principal amount of 5% convertible senior secured debentures maturing March 31, 2006 issued pursuant to three separate Debenture Purchase Agreements dated March 10, 1998, as amended (the "1998 Debentures"), May 26, 1999, as amended (the "1999 Debentures") and December 20, 2002 (the "2002 Debentures"), respectively. The 1998 Debentures, 1999 Debentures and 2002 Debentures are referred to collectively as the "1998-2002 Debentures". After giving effect to the Company's issuance of additional 5% convertible senior secured debentures in satisfaction of interest payments on the 1998-2002 Debentures, as of February 10, 2004, the 1998-2002 Debentures were convertible into an aggregate of approximately 190.4 million shares of the Company's Common Stock.

Conversion Agreement of Holders of 1998-2002 Debentures

Simultaneous with the execution of the 2004 Purchase Agreement, and as a condition to the initial closing of the 2004 Purchase Agreement, the Company, the 2004 Debenture Investor Group and each of the holders of the 1998-2002 Debentures executed a certain Debenture Conversion Agreement, dated as of February 6, 2004 (the "Conversion Agreement"). In accordance with the terms of the Conversion Agreement, each holder of the 2004 Debentures agreed to convert the 2004 Debentures held by such holder into the Company's Series A Preferred shares and each holder of 1998-2002 Debentures agreed to convert the 1998-2002 Debentures held by such holder into the Company's Series B convertible preferred stock (the "Series B Preferred") and/or Series C-1, C-2 and/or C-3 convertible preferred stock (collectively, the "Series C Preferred"). The Series C Preferred shares together with the Series B Preferred shares are herein referred to as, the "Junior Preferred Shares", and the Junior Preferred Shares together with the Series A Preferred, are collectively referred to as the "Preferred Stock". The Conversion Agreement provides, among other things, for the automatic conversion of the 2004 Debentures and the 1998-2002 Debentures (collectively, the "Outstanding Debentures") into the appropriate class of Preferred Stock immediately following the Company's receipt of shareholder approval to the Charter Amendment authorizing the creation of the Preferred Stock and the filing of the Charter Amendment with the Office of the New York Department of State.

Shares of Junior Preferred Stock Resulting from Conversion of 1998-2002 Debentures

Under the Conversion Agreement, the holders of approximately $6.6 million in principal amount of 2002 Debentures issued during 2003 will convert such 2002 Debentures (plus accrued and unpaid interest) into Series B Preferred Shares. Of the remaining approximate $80 million in principal amount of the 1998-2002 Debentures, approximately $31.2 million is comprised of 1998 Debentures, approximately $21.5 million is comprised of 1999 Debentures and approximately $27.3 million is comprised of 2002 Debentures. The 1998 Debentures will be converted into Series C-1 Preferred shares. The 1999 Debentures will be converted into Series C-2 Preferred shares. The remaining balance of the 2002 Debentures shall be converted into Series C-3 Preferred shares.

Shares of Common Stock Resulting from Conversion of Junior Preferred Shares

The number of Junior Preferred Shares to be received by each holder of 1998-2002 Debentures is based on the respective prices at which the 1998-2002 Debentures were convertible into Common Stock. The 2002 Debentures issued in 2003 have a conversion price of $0.3420 per share. The 1998 Debentures, 1999 Debentures and the remaining balance of the 2002 Debentures have conversion prices of $0.5776, $0.5993 and $0.3481 per share, respectively. Based on the respective conversion prices of the 1998-2002 Debentures, and estimating the interest accrual on the 1998-2002 Debentures prior to the Charter Amendment Filing Date, the 1998-2002 Debentures are convertible into an aggregate of approximately 20.0 million Series B Preferred shares, 56.5 million Series C-1 Preferred shares, 37.5 million Series C-2 Preferred shares and 80.9 million Series C-3 Preferred shares.

Liquidation Preference of Junior Preferred Shares

In general, the Junior Preferred Shares have a liquidation preference equal to one (1) time the principal amount plus accrued and unpaid interest of the 1998-2002 Debentures converted into Junior Preferred Shares The liquidation preference of the Series B Preferred has priority over, and will be satisfied prior to, the liquidation preference of the Series C Preferred. The liquidation preference for each class of the Junior Preferred Shares is equal to the conversion prices of such shares. The Junior Preferred Shares are convertible into the Company's Common Stock, with each Junior Preferred Share convertible into one share of Common Stock. The holders of the Junior Preferred Shares have the right to vote as part of the single class with all holders of the Company's Common Stock and the holders of the Series A Preferred on all matters to be voted on by such stockholders, with each holder of Junior Preferred Shares having such number of votes as shall equal the number of votes he would have had if such holder had converted all Junior Preferred Shares held by such holder into Common Stock immediately prior to the record date relating to such vote.

Amendment to Watson Term Loan Agreement

The Company was a party to a certain loan agreement with Watson Pharmaceuticals ("Watson") pursuant to which Watson made term loans to the Company (the "Watson Term Loan Agreement") in the aggregate principal amount of $21.4 million as evidenced by two promissory notes (the "Watson Notes"). It was a condition to the completion of the 2004 Debenture Offering that simultaneous with the closing of the 2004 Purchase Agreement, the Company shall have paid Watson the sum of approximately $4.3 million (which amount was funded from the proceeds of the 2004 Debenture Offering) and conveyed to Watson certain Company assets in consideration for Watson's forgiveness of approximately $16.4 million of indebtedness under the Watson Notes. A part of such transaction, the Watson Notes were amended to extend the maturity date of such notes from March 31, 2006 to June 30, 2007, to provide for satisfaction of future interest payments under the Watson Notes in the form of the Company's Common Stock, to reduce the principal amount of the Watson Notes from $21.4 million to $5.0 million, and to provide for the forbearance from the exercise of rights and remedies upon the occurrence of certain events of default under the Watson Notes (the Watson Notes as so amended, the "New Watson Note"). Simultaneous with the issuance of the New Watson Note, each of the Lead 2004 Investors and the other investors in the 2004 Debentures as of February 10, 2004 (collectively, the "Watson Note Purchasers") purchased the New Watson Note from Watson in consideration for a payment to Watson of $1.0 million.

In addition to Watson's forgiveness of approximately $16.4 million under the Watson Notes, as additional consideration for the Company's payment to Watson of approximately $4.3 million and the Company's conveyance of certain Company assets, all supply agreements between the Company and Watson were terminated and Watson waived the dilution protections contained in the Common Stock purchase warrant dated December 20, 2002 exercisable for approximately 10.7 million shares of the Company's Common Stock previously issued by the Company to Watson, to the extent such dilution protections were triggered by the transactions provided in the 2004 Debenture Offering.

Terms of the New Watson Note

The New Watson Note in the principal amount of $5.0 million as purchased by the Watson Note Purchasers is secured by a first lien on all of the Company's and its subsidiaries' assets, senior to the lien securing the Outstanding Debentures and all other Company indebtedness, carries a floating rate of interest equal to the prime rate plus 4.5% and matures on June 30, 2007.

Net Proceeds from the 2004 Debenture Offering

After giving effect to the payment to Watson of approximately $4.3 million to restructure the Watson Term Loan and the payment of legal and other professional fees relating to the 2004 Debenture Offering, the Company realized net proceeds from the 2004 Debenture Offering of approximately $7.3 million (the "2004 Debenture Offering Proceeds").

Sale of Certain Company Assets to Mutual

On February 18, 2004, the Company and Mutual Pharmaceutical Company, Inc. ("Mutual") entered into a certain Asset Purchase Agreement (the "Mutual Asset Purchase Agreement"). Pursuant to the terms of the Mutual Asset Purchase Agreement, the Company sold certain inactive, non-revenue generating ANDAs to Mutual in consideration of $2.0 million. The ANDAs sold to Mutual are set forth below.

THERAPEUTIC CATEGORY	APPROXIMATE NUMBER OF ANDAS
Analgesic	29
Anti-Infective	14
Antihypertensive/Cardiac	32
Antihistamine	6
Steroid	12
Cough & Cold	7
Central Nervous System	42
Other	10

The Company's decision to divest the above generic product ANDAs was based on (i) the Company's revised business strategy which focuses on research and development of novel and proprietary abuse deterrent formulation technology and opioid active pharmaceutical ingredient synthesis technologies, (ii) the Company had ceased operations at its finished dosage generic product manufacturing and packaging facilities and was in the process of negotiating for the sale of such facilities and (iii) these ANDAs were inactive, non revenue producing generic product ANDAs which had never been qualified for manufacturing or commercial distribution in the Company's Congers, NY generic product manufacturing facilities. These ANDAs were therefore not deemed to be operating assets of the Company.

Sale of Certain Company Assets to IVAX

On March 19, 2004, the Company and its wholly-owned subsidiary, Axiom Pharmaceutical Corporation, entered into an Asset Purchase Agreement with IVAX Pharmaceuticals New York LLC ("IVAX"). Pursuant to the Purchase Agreement, the Company and Axiom agreed to sell to IVAX substantially all of the Company's assets used in the operation of the Company's former generic manufacturing and packaging operations located in Congers, New York in consideration of an immediate payment of $2.0 million and an additional payment $0.5 million upon receipt of shareholder approval of the transaction to be sought at the Company's annual meeting of shareholders to be held on August 12, 2004. Pending Shareholder approval, the Company has recorded the initial payment of $2.0 million as a short term liability.

After giving effect to the payment of legal and other professional fees relating to the divestment of the ANDAs to Mutual and the proposed divestment of certain assets to IVAX, the Company estimates that it will realize aggregate net proceeds from such transactions of approximately $4.3 million. (the "Asset Divestment Proceeds")

ADF Technology Research and Development

The Company's primary business focus is the research and development of proprietary abuse deterrent formulation technologies (the "ADF Technology") intended to deter the abuse of opioid containing orally administered prescription products. The ADF technology has been tested in a variety of non-clinical settings and a patent application was filed with the United States Patent and Trademarks Office in the fourth quarter of 2003 (see discussion below under the caption "Patent Applications"). The Company's first product candidate ("ADF Product Candidate #1") resulting from the ADF Technology is a tablet formulation intended for oral administration. ADF Product Candidate #1 is currently undergoing required drug stability testing prior to regulatory submission. To date the Company can provide no assurances that the stability of ADF Product Candidate #1 will result in a commercially acceptable drug product. In addition, ADF Product Candidate #1 is also currently under evaluation in a clinical study to assess the bio-availability of such product candidate in comparison to a frequently prescribed commercially marketed drug product with the same opioid active ingredient but without abuse deterrent properties. The final results from such clinical study are expected to be available in the second half of 2004. There can be no assurances that ADF Product Candidate #1 will be bio-available or bioequivalent to the extent required to justify continued clinical testing. To receive marketing authorization for commercial distribution in the United States, all drug products formulated with the ADF Technology will require the development, submission and filing of a new drug application ("NDA") and approval of such application by the U.S. Food and Drug Administration (the "FDA"). In the event that ADF Product Candidate #1 is stable and demonstrates acceptable bio-availability, then substantial additional clinical and non-clinical testing will be required prior to the submission of an NDA. There can be no assurances that ADF Product Candidate #1 will lead to an NDA submission or that if an NDA is filed, that the FDA will approve such regulatory application for commercial distribution.

Opioid Synthesis Technology Research and Development

The Company is also engaged in the research, development and scale-up of a variety of proprietary manufacturing processes for opioid active pharmaceutical ingredients (the "Opioid Synthesis Technologies") as generally described in the table below.

OPIOID SYNTHESIS TECHNOLOGY	STARTING MATERIAL	ESTIMATED YIELD	APPLICABLE DEA REGISTRATIONS REQUIRED	STATUS OF PATENT APPLICATION
Oxycodone HCl	Codeine Phosphate	40 - 50%	a) Research	One (1) Notice of Allowance issued
Process #1			b) Manufacturing	One (1) other Patent Pending before the PTO
Hydrocodone Bitartrate	Codeine Phosphate	85%	a) Manufacturing	Patent Application filed in the second quarter of 2004
Process #1				
Oxycodone HCl	NRMs	68 - 72%	a) Research	Patent Application filed in July 2004
Process #2			b) Manufacturing	
			c) Import	
Codeine Phosphate	NRMs	90 - 100%	a) Research	Patent Application filed in the second quarter of 2004
Process #1			b) Manufacturing	
			c) Import	
Codeine Phosphate	NRMs	80-90%	a) Research	Patent Application filed in the second quarter of 2004
Process #2			b) Manufacturing	
			c) Import	
Codeine Phosphate	NRMs	65-85%	a) Research	Patent Application filed in the fourth quarter of 2003
Process #3			b) Manufacturing	
			c) Import	
Hydrocodone Bitartrate	Codeine Base	85 - 95%	a) Research	Patent Application filed in the second quarter of 2004
Process #2			b) Manufacturing	
Morphine Sulfate	NRMs	96%	a) Research	Patent Application expected to be filed by the second quarter of 2005
			b) Manufacturing	
			c) Import	
Dihydrocodeine Bitartrate	Codeine Base	>90%	a) Research	Patent Application filed in the second quarter of 2004
			b) Manufacturing	

The Company believes at this stage of development that, except for oxycodone hydrochloride process #1, the Opioid Synthesis Technologies are efficient and cost-effective methods of manufacturing opioid APIs. The Company believes that the primary advantages of these processes include a substantial reduction in the time and number of processing steps required to produce the desired opioid APIs and reduction of the quantity and/or toxicity of the waste products relating to such production. The Company believes that at the current manufacturing scale Hydrocodone Bitartrate Process #1 meets all USP release testing specifications, provides high yields and high levels of purity compared to competitive manufacturing processes used for this active ingredient. The development and documentation of Hydrocodone Process #1 has been completed and the Company believes such process is ready to be tested at full commercial scale. Until such time, if any, as the Company secures third-party financing dedicated to scale up expenses (as defined below under the caption "Hydrocodone Bitartrate Option Agreement") the Company will be unable to complete the commercial scale up of the Hydrocodone Bitartrate Process #1 or the other Opioid Synthesis Technologies in the above table. No assurance can be given that the Company will obtain the third-party financing necessary to scale-up the Opioid Synthesis Technologies or that if such financing is obtained, that any one or more of the Opioid Synthesis Technologies will be capable of commercial scale up.

Patent Applications

To date, the Company has filed seven (7) patents applications with the United States Patent and Trademark Office ("PTO") and one (1) foreign application relating to the Opioid Synthesis Technologies including two (2) in June 2003, one (1) in October 2003 and four (4) in May 2004 and one (1) patent application relating to the ADF Technology in the fourth quarter of 2003. The typical review time of a U.S. patent application varies. The initial review generally occurs approximately 12 to 18 months from date of patent filing. At the completion of the initial review, the patent examiner will issue an Office Action letter, which will detail any necessary amendments, supplements or reasons for the rejection. Subsequent processing of the patent application will depend on the number of Office Action letters issued and the speed of review of the Company's responses thereto. If an application is granted, a Notice of Allowance will be issued, requiring a payment of the issue fee within three (3) months from the date of the notice. Upon the payment of the fee, the patent would be issued.

In March 2004 the Company received a notice of allowance from the PTO relating to one of the patent applications filed in June of 2003. The Company has paid the issue fee and expects a U.S. patent will be granted from that application. No assurance can be given, however, that any other currently pending patent applications or future patent applications relating to the Opioid Synthesis Technologies will be granted. In addition, the Company is currently unable to provide any assurance that the U.S. patent application associated with the ADF Technology will issue, or if such patent issues, that the claims granted will be sufficiently broad to provide economic value.

Import License Registration

To provide for an economical source of raw materials for the commercial manufacture of opioids utilizing certain of the Opioid Synthesis Technologies, the Company filed with the U.S. Drug Enforcement Agency (the "DEA") an application for registration to import certain narcotic raw materials ("NRMs"). The Company filed its application for registration to import NRMs on January 31, 2001 (the "Import Registration"). Notice of the Company's application was published in the Federal Register on September 6, 2001. Within the 30 day period provided under DEA guidelines, three parties, including two companies that the Company believes are the largest U.S. importers of NRMs requested a hearing to formally object to the Company's request for an Import Registration. Pursuant to established procedures, an evidentiary hearing relating to the Company's Import Registration application was held before a DEA Administrative Law Judge ("ALJ") in August 2003. The ALJ later re-opened the administrative record, at the request of opposing parties, to consider the Company's November and December 2003 announcements concerning the Company restructuring and financing activities. After submission of additional testimony by the Company and certain of the opposing parties, the ALJ closed the evidentiary record effective May 25, 2004. Additionally, as of August 3, 2004, the Company and the opposing parties prepared and submitted briefing documents to the ALJ based on the evidentiary record. With the evidentiary record now closed, the ALJ will make findings of fact, draw legal conclusions and recommend a specific decision on the Company's Import Registration application to the DEA and issue a final order relating to the Company's application. Following the decision of the ALJ, the DEA will judge whether the issuance of an Import Registration is appropriate. Assuming DEA grants the Company's application, of which no assurance can be given, the Company would be permitted to import NRMs upon appropriate notice in the Federal Register. The opposing parties may challenge the DEA decision to grant the Company's application in an appropriate Court of Appeals. In such a case, assuming the Company opposes an appellate challenge, the Company would likely incur additional time delays and legal expenses prior to the issuance of a final decision by the U.S. Court of Appeals. Provided the Company continues to seek the Import Registration, the proceedings will continue through 2004 and beyond.

No assurance can be given that the Company's Import Registration application will be approved by the DEA or that if granted by DEA, the Import Registration would be upheld following an appellate challenge. Furthermore, the Company's cash flow and limited sources of available financing make it uncertain that the Company will have sufficient capital to continue to fund the development of the Opioid Synthesis Technologies, to obtain required DEA approvals and to fund the capital improvements necessary for the manufacture of APIs and finished dosage products incorporating the Opioid Synthesis Technologies.

Hydrocodone Bitartrate Option Agreement

The Company estimates that to scale up its Hydrocodone Bitartrate Process #1 Opioid Synthesis Technology to desirable commercial scale at its Culver Facility, additional funding of approximately $7.0 million will be required for facility improvements, the purchase, installation and validation of new API manufacturing equipment, environmental waste management compliance, the preparation of the drug master files for the API to be produced at the facility, and related direct labor expense (collectively, the "API Scale Up Expenses"). The Company is a party to a certain Hydrocodone Option Agreement dated February 6, 2004 with Watson Pharmaceuticals ("Watson") pursuant to which the Company has granted Watson a six (6) month exclusive option (the "Hydrocodone Option") to enter into a supply agreement with the Company for supply of hydrocodone bitartrate API (the "Hydrocodone API"). If such option is exercised by Watson, at Watson's sole discretion, of which there can be no assurance, Watson will fund 50% of the API Scale Up Expenses, up to a maximum of $3.5 million and the Company has agreed to use commercially reasonable efforts to obtain financing dedicated to fund its portion of the API Scale Up Expenses. In the event the Company is unable to secure financing dedicated to fund its portion of the API Scale Up Expenses, the Hydrocodone Option provides that the parties will discuss alternatives relating to the scale up of the its Opioid Synthesis Technology for Hydrocodone API. On August 4, 2004 the Hydrocodone Option Agreement with Watson expired unexercised.

As described in this Report, no portion of the 2004 Debenture Offering Proceeds or the Asset Divestment Proceeds is budgeted for the API Scale Up Expenses. Until such time, if any, as the Company secures third-party financing dedicated to the API Scale Up Expenses, the Company will be unable to complete the commercial scale up of its Opioid Synthesis Technologies.

Commercial Focus, Cash Reserves and Funding Requirements of the Restructured Company

The 2004 Debenture Offering Proceeds, the Asset Divestment Proceeds and the Company's other cash balances (as reduced by operating expenses through July 31, 2004) provided the Company with approximately $5,750,000 million in cash reserves at August 1, 2004. Except for the professional fees related to the prosecution of the Import Registration, all of such cash reserves will be dedicated to the development of the Company's ADF Technology, the Opioid Synthesis Technologies and for administrative and related operating expenses.

Subsequent to the completed restructuring of its operations, the Company is no longer engaged in the manufacture and sale of finished dosage generic pharmaceutical products. As a result, the Company has no ability presently to generate revenue from product sales. Accordingly, the Company must rely on its current cash reserves to fund the development of its ADF Technology, the Opioid Synthesis Technologies and related ongoing administrative and operating expenses. The Company's future sources of revenue, if any, will be derived from the sale of API manufactured using its Opioid Synthesis Technologies and from contract signing fees, milestone payments and royalties and/or profit sharing payments from licensees for the Company's ADF Technology or Opioid Synthesis

Technologies. The Company estimates that its current cash reserves will be sufficient to fund the development of the ADF Technology, the Opioid Synthesis Technologies and related operating expenses through January 2005. To fund operations through December, 2005, the Company estimates that it must raise additional financing, or enter into alliances or collaboration agreements with third parties providing for net proceeds to the Company of at least $5 million. No assurance can be given that the Company will be successful in obtaining any such financing or in securing collaborative agreements with third parties on acceptable terms, if at all, or if secured, that such financing or collaborative agreements will provide for payments to the Company sufficient to continue to fund operations. In the absence of such financing or third-party collaborative agreements, the Company will be required to scale back or terminate operations and/or seek protection under applicable bankruptcy laws.

Even assuming the Company is successful in securing additional sources of financing to fund the continued development of the ADF Technology or the Opioid Synthesis Technologies, or otherwise enters into alliances or collaborative agreements relating to such technologies, there can be no assurance that the Company's development efforts will result in commercial scale technologies, or that if such technologies are capable of being scaled up, that they will result in commercially viable products. The Company is also unable to provide any assurance that it will succeed in its application to the DEA for the Import Registration. The Company's failure to successfully develop the ADF Technology in a timely manner will have a material adverse impact on its financial condition and results of operations.

Additional Considerations Relating to the Company

The Company's financial success will depend on its ability to successfully implement its new business strategy.

In accordance with the restructuring of the Company's operations, the Company has transitioned to a single operations facility located in Culver, Indiana. At such site, the Company will seek to develop and commercialize its proprietary ADF Technology and Opioid Synthesis Technologies. With respect to the ADF Technology, the first product candidate ("ADF Product Candidate #1") resulting from the ADF Technology is a tablet formulation intended for oral administration. Such product candidate is currently undergoing stability testing and the Company can provide no assurance that the stability of ADF Product Candidate #1 will result in a commercially acceptable drug product. In addition, ADF Product Candidate No. 1 is currently under evaluation in a clinical study to assess the bio-availability of such product candidate in comparison to a frequently prescribed commercially marketed drug product with the same opioid active ingredient but without abuse deterrent properties. There can be no assurance that ADF Product Candidate #1 will be bio-available or bioequivalent to the extent required to justify continued clinical testing. Moreover, even if ADF Product Candidate #1 is stable and demonstrates acceptable bio-availability, substantial additional clinical and non-clinical testing will required to continue development and for the preparation and submission of an NDA filing with the FDA. There can be no assurance that ADF Product Candidate #1 or any other product developed using the ADF Technology will lead to an NDA submission to the FDA and that if an NDA is filed, that the FDA will approve such regulatory application to allow for commercial distribution of the product.

With respect to the Opioid Synthesis Technologies, while the Company believes that the such technologies are effect and cost-effective methods of manufacturing opioid APIs, such technologies will need to be scaled up to commercial scale in order to have economic value, of which assurance can be given. Additionally, until such time as the Company secures third-party financing dedicated to the scale up expenses relating to the Opioid Synthesis Technologies (estimated by the Company to be approximately $7.0 million), the Company will be unable to complete the commercial scale up of the Opioid Synthesis Technologies. No assurance can be given that the Company will obtain the third-party financing necessary to scale up the Opioid Synthesis Technologies or that if such financing is obtained, that any one or more of the Opioid Synthesis Technologies will be capable of commercial scale up.

The Company is committing substantially all of its resources and available capital to the development of the ADF Technology, the Opioid Synthesis Technologies and the prosecution of its patent applications and the Import

Registration. The failure of the Company to successfully development the ADF Technology or to successfully obtain an issued patent from the PTO will have a material adverse effect on the Company's operations and financial condition. The Company's cash flow and limited sources of available financing make it uncertain that the Company will have sufficient capital to continue to fund operations or to otherwise complete the development of the Opioid Synthesis and ADF Technologies, to obtain required DEA and FDA approvals, and to successfully prosecute its patent applications. The Company currently does not have the funds necessary to make the capital improvements required for the commercial scale manufacture of API's and finished dosage products incorporating such technologies.

The Company has no near term sources of revenue and must rely on current capital resources and third party financing to fund operations.

Pending the completion of the development and commercial scale up of the Company proprietary technologies, and the receipt of regulatory approval of products incorporating such technologies, of which no assurance can be given, the Company must rely on its current capital resources and available third-party financing to fund the Company's operations. As a consequence of the Company's restructuring of operations, including the cessation of its finished dosage manufacturing and packaging operations at the Congers Facilities and the proposed sale of the related assets to IVAX, the Company will have no ability to generate revenues from the sale of generic products. As a result, the Company must rely on its current cash resources or available third-party financing to fund operations. As of August 1, 2004, the Company had cash and cash equivalents of approximately $5,750,000 million, plus an anticipated additional $500,000 to be paid by IVAX on the closing of the asset sale transaction following the receipt of shareholder approval. No assurance can be given that such cash resources will be sufficient to fund the continued development and commercialization of the Company's proprietary technologies until such time as the Company generates revenue from the license of products incorporating such technologies to third parties. Moreover, in the event of a cash shortfall, no assurance can be given that the Company will succeed in raising additional financing to fund operations or that if funding is obtained, that such funding will be sufficient to fund operations until the Company's proprietary technologies, or products incorporating such proprietary technologies, may be commercialized.

The Company received a "going concern" opinion from its independent auditors, has a history of operating losses and may not achieve profitability sufficient to generate a positive return on shareholders' investment.

The Company has incurred net losses since 1992. The Company's consolidated financial statements for the year ended December 31, 2003 and the quarter ended June 30, 2004 have been prepared on a going-concern basis, expressing substantial doubt about the Company's ability to continue as a going-concern as a result of recurring losses and negative cash flows. The Company's loss from operations for the year ended December 31, 2003 and the six months ended June 30, 2004 was approximately $17.2 million and $4.2 million, respectively. The Company's accumulated deficit as of June 30, 2004 was $225.9 million. The Company expects to incur net operating losses at least through 2004. There can be no assurance that the Company will ever generate revenues or achieve profitability at a level sufficient to generate a positive return on shareholders' investment. If the Company is unable to successfully develop and commercialize its proprietary technologies with its currently available cash resources or available sources of third-party financing, the Company's ability to execute its business plan and remain a going-concern will be significantly impaired.

There can be no assurance that even if the Company is successful in developing and commercializing its proprietary technologies, that products incorporating such technologies will be accepted in the market.

The commercial success of products incorporating the Company's technologies that are approved for marketing by the FDA and other regulatory authorities will depend upon their acceptance by the medical community and third party payors as clinically useful, cost effective and safe. There can be no assurance that, even if the Company succeeds in the development of products incorporating its technologies and receives FDA approval for such products, that the Company's products will be accepted by the medical community and others. Factors that the

Company believes could materially affect market acceptance of its products include:

- The relative advantages and disadvantages of the Company's technologies and timing to commercial launch of products utilizing such technologies compared to products incorporating competitive technologies;

- The timing of the receipt of market approvals and the countries in which such approvals are obtained;

- The safety and efficacy of products incorporating the Company's technologies as compared to competitive products; and

- The cost-effectiveness of the products incorporating the Company's technologies and the ability to receive third party reimbursement.

The Company must obtain required regulatory approvals from the FDA and DEA.

The Company's business strategy focuses on the development of opioid containing products incorporating the Company's proprietary technologies. The development, marketing and sale of products incorporating the Company's technologies is subject to extensive regulation by the DEA and FDA. At present, the Company's facility located in Culver, Indiana is approved to manufacture Schedule II to V controlled substance APIs and finished dosage products. To continue the development and commercialization of the Company's API Technologies, the Company is seeking to obtain a registration from the DEA to import narcotic raw materials ("NRMs") and has begun the application process seeking approval to import NMRs directly from foreign countries for use in the Company's opioid API manufacturing efforts.

The Company filed its application for registration to import NRMs on January 31, 2001 (the "Import Registration"). Notice of the Company's application was published in the Federal Register on September 6, 2001. Within the 30 day period provided under DEA guidelines, three parties, including two companies that the Company believes are the largest U.S. importers of NRMs requested a hearing to formally object to the Company's request for an Import Registration. Pursuant to established procedures, an evidentiary hearing relating to the Company's Import Registration application was held before a DEA Administrative Law Judge ("ALJ") in August 2003. The ALJ later re-opened the administrative record, at the request of opposing parties, to consider the Company's November and December 2003 announcements concerning the Company restructuring and financing activities. After submission of additional testimony by the Company and certain of the opposing parties, the ALJ closed the evidentiary record effective May 25, 2004. The Company and the opposing parties have a deadline in August 2004 to prepare and submit briefing documents to the ALJ based on the evidentiary record. Thereafter the ALJ will make findings of fact, draw legal conclusions and recommend a specific decision on the Company's Import Registration application to the DEA and issue a final order relating to the Company's application. Following the decision of the ALJ, the DEA will judge whether the issuance of an Import Registration is appropriate. Assuming DEA grants the Company's application, of which no assurance can be given, then the Company would be permitted to import NRMs upon appropriate notice in the Federal Register. The opposing parties may challenge the DEA decision to grant the Company's application in an appropriate Court of Appeals. In such a case, assuming the Company opposes an appellate challenge, the Company would likely incur additional time delays and legal expenses prior to the issuance of a final decision by the U.S. Court of Appeals. Provided the Company continues to seek the Import Registration, the proceedings will continue through 2004 and beyond.

No assurance can be given that the Company's Import Registration application will be approved by the DEA or that if granted by DEA, the Import Registration would be upheld following an appellate challenge. Furthermore, the Company's cash flow and limited sources of available financing make it uncertain that the Company will have sufficient capital to continue to fund the development of the Opioid Synthesis Technologies, to obtain required DEA approvals and to fund the capital improvements necessary for the manufacture of APIs and finished dosage products incorporating the Opioid Synthesis Technologies.

The marketing and sale of products incorporating the Company's technologies requires FDA approval, which can be time-consuming and expensive.

The development, testing, manufacture, marketing and sale of pharmaceutical products are subject to extensive federal, state and local regulation in the United States and other countries. The regulatory approval process and the Company's ongoing compliance with FDA regulations, is time-consuming and often expensive. Substantially all of the Company's activities are subject to compliance with FDA regulations. Failure to adhere to applicable FDA regulations would have a material adverse effect on the Company's financial condition. In addition, in the event the Company is successful in developing products for sale in other countries, the Company would be subject to regulation in such countries.

The Company may encounter delays or rejections during any stage of the regulatory approval process based upon the failure of clinical or laboratory data to demonstrate compliance with, or upon the failure of the product to meet, the FDA's requirements for safety, efficacy and quality. After the Company's submission to the FDA of a marketing application, in the form of a new drug application and/or a 505(b)(2) application the FDA may deny the application, may require additional testing or data and/or may require post-marketing testing and surveillance to monitor the safety or efficacy of a product. The FDA commonly takes one to two years to grant final approval to a marketing application. Further, the terms of approval of any marketing application, including the labeling content, may be more restrictive than the Company desires and could affect the marketability of products incorporating the Company's technologies.

The FDA also has the authority to revoke or suspend approvals of previously approved products for cause, to debar companies and individuals from participating in the drug-approval process, to request recalls of allegedly violative products, to seize allegedly violative products, to obtain injunctions to close manufacturing plants allegedly not operating in conformity with current Good Manufacturing Practice regulations and to stop shipments of allegedly violative products. Any future source of Company revenue will be derived from the sale of FDA approved products, and the taking of any such action by the FDA would have a material adverse effect on the Company.

The Company may become involved in patent litigation or other intellectual property proceedings relating to is products or technologies, which could result in liability for damages or stop the Company's development and commercialization efforts.

The pharmaceutical industry has been characterized by significant litigation and other proceedings regarding patents and other intellectual property rights. The situations in which the Company may become a party to such litigation or proceedings include:

- The Company may initiate litigation or other proceedings against third parties to enforce the Company's patent rights;

- The Company may initiate litigation or other proceedings against third parties to seek to invalidate the patents held by such third parties or to obtain a judgment that the Company's products or processes due not infringe such third parties' patents;

- If the Company's competitors file patent applications claiming technology also claimed by the Company, the Company may participate in interference or opposition proceedings to determine the priority of inventions;

- If third parties initiate litigation claiming that the Company's processes or products infringe such third parties' patent or intellectual property rights, the Company will need to defend against such proceedings; and

- An adverse outcome in any litigation or other proceeding could subject the Company to significant liabilities to third parties and require that the Company cease using the technology that is at issue or to license the technology from third parties. The Company may not be able to obtain any required license on commercially acceptable terms or at all.

The cost of any patent litigation or other proceeding, even if resolved in the Company's favor, could be substantial. Uncertainties resulting from the initiation and continuation of patent litigation or other proceedings could have a material adverse effect on the Company's ability to compete in the marketplace. Patent litigation and other proceedings may also consume significant management time.

The Company faces significant competition, which may result in others discovering, developing or commercializing products before or more successfully than the Company.

The pharmaceutical industry is highly competitive and is affected by new technologies, government regulations, health care legislation, availability of financing, litigation and other factors. Most of the Company's competitors have longer operating histories and greater financial and other resources than the Company.

The Company will be concentrating essentially all of its efforts and resources on the development of its proprietary technologies. The success of products incorporating such technologies, if any, will depend, in large part, on the intensity of competition from branded and generic opioid containing products, abuse deterrent and opioid synthesis technologies developed by other companies that compete with the Company's technologies and the relative timing of product approval by the FDA of the Company's products compared to competitive products.

CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, which was released by the Securities and Exchange Commission ("SEC") in December 2001, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note A of the Notes to Consolidated Financial Statements, as contained in the Company's Annual Report on Form 10-K, includes a summary of the Company's significant accounting policies and methods used in the preparation of the financial statements. In preparing these financial statements, the Company has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. The Company does not believe there is a great likelihood that materially different amounts would be reported under different conditions or using different assumptions. The Company's critical accounting policies are as follows:

Revenue Recognition

The Company recognizes revenue at the time a product is shipped to customers. The Company established sales provisions for estimated chargebacks, discounts, rebates, returns, pricing adjustments and other sales allowances concurrently with the recognition of revenue. The sales provisions are established based upon consideration of a variety of factors, including but not limited to, actual return and historical experience by product type, the number and timing of competitive products approved for sale, the expected market for the product, estimated customer inventory levels by product, price declines and current and projected economic conditions and levels of competition. Actual product return, chargebacks and other sales allowances incurred are, however, dependent upon future events. Management continually monitors the factors that influence sales allowance estimates and make adjustments to these provisions when allowances may differ from established allowances.

Allowance For Doubtful Accounts

Estimates are used in determining the allowance for doubtful accounts based on the Company's historical collections experience, current trends, credit policy and a percentage of its accounts receivable by aging category. In determining these percentages, the Company looks at historical write-offs of its receivables. The Company also looks at the credit quality of its customer base as well as changes in its credit policies. The Company continuously monitors collections and payments from its customers. While credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past .

Inventories

The Company's inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out basis. In evaluating whether inventory is stated at the lower of cost or market, management considers such factors as the amount of inventory on hand, remaining shelf life and current and expected market conditions, including levels of competition. As appropriate, the Company records provisions to reduce inventories to their net realizable value.

Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and loss carry-forwards for which income tax benefits are expected to be realized in future years. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount expected to be realized. In estimating future tax consequences, the Company generally considers all expected future events other than an enactment of changes in the tax laws or rates. The Company has recorded a full valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. While the Company has considered future taxable income in assessing the need for the valuation allowance, in the event the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Stock Compensation

The Company accounts for stock-based employee compensation arrangements in accordance with provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and complies with the disclosure provision of SFAS No. 148, "Accounting for Stock-based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123" ("SFAS No. 148"). If the Company were to include the cost of stock-based employee compensation in the financial statements, the Company's operating results would decline based on the fair value of the stock-based employee compensation.

Deferred Debt Discount

Deferred debt discount results from the issuance of stock warrants and beneficial conversion features in connection with the issuance of subordinated debt and other notes payable. The amount of the discount is recorded as a reduction of the related obligation and is amortized over the remaining life of the related obligations. Management determines the amount of the discount, based, in part, by the relative fair values ascribed to the warrants determined by an independent valuation or through the use of the Black-Scholes valuation model. Inherent in the Black-Scholes valuation model are assumptions made by management regarding the estimated life of the warrant, the estimated volatility of the Company's common stock and the expected dividend yield.

ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14 as of the end of the period covered by this Report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic Securities and Exchange Commission filings. No significant changes were made in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Disclosure controls and procedures are those controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

PART II

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEED AND ISSUER PURCHASES OF EQUITY SECURITIES

During the quarter ended June 30, 2004, the Company issued Convertible Subordinated Debentures in the aggregate principal amount of approximately $1,687,000 (the "Convertible Debentures") and issued 114,321 shares of the Company's common stock as payment of $63,000 accrued interest due April 1, 2004 on the Senior Secured Term Note Payable.

Each of the holders of the Convertible Debentures and the Senior Secured Term Note Payable and shares of common stock issued during the quarter ended June 30, 2004 are accredited investors as defined in Rule 501(a) of Regulation D promulgated under the Securities Act of 1933, as amended (the "Act"). The Convertible Debentures were issued without registration under the Act in reliance upon Section 4(2) of the Act and Regulation D promulgated thereunder.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) The exhibits required to be filed as part of this Report on form 10-Q are listed in the attached Exhibit Index.

(b) Reports on Form 8-K.

The Company filed a Current Report on Form 8-K dated April 22, 2004 relating to it financial results for the fourth quarter ended December 31, 2003 and the twelve months ended December 31, 2003.

The Company filed a Current Report on Form 8-K dated May 26, 2004 relating to the filing by the Company of four non-provisional patent applications with the US Patent and Trademark Office relating to the Company's opioid synthesis technologies.

The Company filed a Current Report on Form 8-K dated June 10, 2004 relating to (a) the completion of a $14.0 million offering of the Company's convertible debentures pursuant to the Debenture and Share Purchase Agreement executed by the Company in February 2004, and (b) an amendment to the Debenture and Share Purchase Agreement to (i) increase the principal amount of debentures issuable thereunder from $14.0 million to $17.5 million and (ii) extend the time to complete such additional financing from June 5, 2004 to June 30, 2004.

SIGNATURES

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

Date: August 6, 2004

HALSEY DRUG CO., INC.

By:/s/ Andrew D. Reddick

Andrew D. Reddick
President & Chief Executive Officer

By:/s/Peter A. Clemens

Peter A. Clemens
Senior Vice President & Chief
Financial Officer

EXHIBIT INDEX

Exhibit	Document
10.1	Executive Employment Agreement of Vijai Kumar, dated as of November 18, 2002.
10.2	Executive Employment Agreement of Andrew D. Reddick, dated as of August 26, 2003.
10.3	Executive Employment Agreement of Ron Spivey, dated as of April 5, 2004.
10.4	Amendment to Executive Employment Agreement of Andrew D. Reddick, dated as of May 27, 2004.
10.5	Separation Agreement and General Release by and between Michael K. Reicher and Halsey Drug Co., Inc., dated Co., Inc., dated September 18, 2003.
10.6	First Amendment to Separation Agreement and General Release by and between Michael K. Reicher and Halsey Drug Co., Inc., dated as of December 4, 2003.
10.7	Asset Purchase Agreement by and between Mutual Pharmaceutical Company, Inc. and Halsey Drug Co., Inc., dated February 18, 2004.
10.8	First Amendment to Debenture Purchase Agreement by and among Halsey Drug Co., Inc., Galen Partners III, L.P.,Care Capital Investments II, LP, Essex Woodlands Health Ventures V, L.P. and other signatories thereto, dated June 1, 2004.
10.9	Amendment to Debenture and Share Purchase Agreement by and among Halsey Drug Co., Inc., Galen Partners III, L.P., Care Capital Investments II, LP, Essex Woodlands Health Ventures V, L.P. and other signatories thereto, dated August 11, 2003.
10.10	Letter of Support in favor of Halsey Drug Co., Inc. by and among Care Capital Investment II, L.P., Galen Partners III, L.P. and Essex Woodlands Health Ventures V, L.P., dated May 5, 2003.
31.1	Certification of Periodic Report by Chief Executive Officer pursuant to Rule 13a-14 and 15d-14 of the Securities Exchange Act of 1934.
31.2	Certification of Periodic Report by Chief Financial Officer pursuant to Rule 13a-14 and 15d-14 of the Securities Exchange Act of 1934.
32.1	Certification of Periodic Report by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Periodic Report by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

EXHIBIT 10.1

EMPLOYMENT AGREEMENT

EMPLOYMENT AGREEMENT made as of the 18th day of November, 2002 between and among HALSEY DRUG CO., INC., a New York corporation (the "Corporation"), with principal executive offices at 695 N. Perryville Road, Rockford, IL 61107 and VIJAI KUMAR residing at 67 Whitewood Drive, Morris Plains, NJ 09750 (the "Employee").

W I T N E S S E T H

WHEREAS, the Corporation desires to employ the Employee to engage in such activities and to render such services as are required under the terms and conditions hereof and the Board of Directors has authorized and approved the execution of this Agreement; and

WHEREAS, the Employee desires to be employed by the Corporation under the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, the parties agree as follows:

1. Employment, Duties and Acceptance.

1.1 Services. The Corporation hereby employs Employee, for the Term (as hereinafter defined in Section 2 hereof), to render exclusive and full-time services to the business and affairs of the Corporation as the Chief Operations Officer of the Corporation, subject to the direction of the Board of Directors of the Corporation, and, in connection therewith, the Employee shall have all the duties and responsibilities customarily rendered by a Chief Operations Officer, and as may be further reasonably directed or requested to be performed by the Chairman and Chief Executive Officer, to whom the Employee shall report, and to use his best efforts, skill and abilities to promote the interests of the Corporation and its subsidiaries. Employee shall be located at, and operate out of, the Corporation's Congers, New York facility.

1.2 Acceptance. Employee hereby accepts such employment and agrees to render the services described in Section 1.1 hereof.

2. Term of Employment. The term of Employee's employment under this Agreement shall commence on the date of this Agreement and shall expire two (2) years from the date hereof (the "Initial Term"), unless sooner terminated pursuant to Section 7 of this Agreement; provided, however, that the Employee's term hereunder shall automatically be extended for successive one (1) year periods ("Renewal Period"), unless either the Corporation or the Employee provides written notice of non-renewal of Employee's employment with the Corporation ninety (90) days prior to the end of the Initial Term or any Renewal Period (each a "Renewal Period" and together with the Initial Term, the "Term").

3. Compensation. In consideration of the services to be rendered by the Employee pursuant to this Agreement, the Employee shall receive from the Corporation the following compensation:

(a) Base Salary. The Corporation shall pay the Employee an aggregate base salary at the annual rate of $180,000, payable in equal bi-weekly installments, less such deductions or amounts to be withheld as shall be required by applicable laws and regulations. The Employee's Base Salary shall be subject to increase at the discretion of the Board of Directors of the Corporation, in its sole discretion.

(b) Annual Bonus. During the Term, Employee may be eligible to receive from the Corporation an annual bonus, as may be determined by the Board of Directors in its sole discretion, in respect of each fiscal year, or portion thereof, of the Corporation, based on the achievement of such targets, conditions or parameters as may be determined from time to time hereafter by the Compensation Committee of the Board of Directors of the Corporation in its sole and absolute discretion.

4. Expenses. The Corporation shall pay or reimburse Employee for all reasonable expenses which are in accordance with the Corporation's expense policy in force from time to time and which are actually incurred or paid by him during the Term in the performance of his services under this Agreement, upon presentation of expense statements or vouchers or such other supporting information as the Corporation may require.

5. Additional Benefits.

(a) In General. In addition to the compensation and expenses to be paid under Sections 3 and 4 hereof, Employee will be entitled to such rights and benefits for which he may be eligible under any insurance, 401K, bonus, or stock option plan of the Corporation, as the Board of Directors shall determine from time to time in its sole and absolute discretion, adopted for the benefit of executives or employees generally of the Corporation.

(b) Stock Options. Employee is hereby granted stock options to purchase 400,000 shares of the Corporation's common stock, $.01 par value per share (the "Option") at an exercise price representing the closing price for the Company's common stock as reported by the OTC Bulletin Board on the date of hire. The Option shall vest and be exercisable in quarterly amounts upon anniversary date of hire beginning November 18, 2003 and thereafter until fully vested. The Option shall have a ten year term, subject to earlier termination as set forth in paragraph 5(c) upon the termination of Employee's employment with the Corporation and shall be evidenced by the Corporation's standard form stock option agreement. The Employee and the Corporation agree that the Option shall be deemed to have been issued pursuant to one or more plans for the grant of incentive stock options, to the maximum extent permitted by law, and non-qualified stock options for any excess.

(c) Purchase of Options. In the event that Employee is terminated for cause (as defined in paragraph 7.3) or resigns, the Corporation shall have the right, but not the obligation, to purchase Employee's vested Option at the Fair Market Value thereof. In the event that the Corporation does not elect to purchase Employee's vested Option within [seven (7)] days of the date of Employee's termination for cause or resignation, Employee shall be obligated to exercise his Options in writing within thirty (30) days of such termination or resignation, failing which he shall be deemed to have forfeited his Option to the Corporation. For purposes of this paragraph 5(c), "Fair Market Value" shall mean the product of (i) the positive difference, if any, between the average of the closing bid and asked prices of the Company's Common Stock as reported by the OTC Bulletin Board, or such other exchange or over-the-counter market on which the Company's Common Stock may then be listed or admitted for trading, for the five (5) trading days prior to the date of termination, multiplied by (ii) the number of Option Shares which, as of the date of termination, are vested under the Option.

6. Vacation. Employee shall be entitled to a vacation period of not less than [four] weeks during each year of the Term, to be taken at a time or times acceptable to the Corporation.

7. Termination.

7.1 Death. If during the Term Employee shall die, Employee's employment under this Agreement shall terminate as of the date of Employee's death. The base salary payable hereunder to or for the benefit of Employee through the date of death shall be paid to such person or persons ("Employee's Designees") as Employee may designate by notice to the Corporation from time to time or, in the absence of such designation, to his spouse.

7.2 Disability. In the event of the Employee's "mental or physical disability" (as defined herein) which continues for (i) a period of longer than 45 consecutive days, or (ii) such periods aggregating 90 days during any 365 consecutive days, such that the Employee is, despite reasonable accommodation, unable to substantively perform the essential functions of his position for said period, the determination of which shall be confirmed by the Board of Directors in the manner hereinafter provided, this Agreement shall terminate upon thirty (30) days' prior written notice to the Employee from the Corporation (the "Disability Termination Date"). The Corporation shall continue to pay to the Employee during the period of his mental or physical disability the base salary provided in Section 3 of this Agreement as well as provide the benefits described herein; provided, however, that the base salary shall be reduced by any disability insurance payments paid to the Employee. On the Disability Termination Date, Employee's base salary shall cease.

As used herein, the term "mentally or physically disabled" shall have the meaning ascribed thereto in the disability insurance policy then in force and effect with respect to the Employee or, if no such disability policy then exists, it shall mean the inability of the Employee, by reason of physical or mental injury, illness or other similar cause to perform a material part of his duties and responsibilities in connection with the conduct of the business and affairs of the Corporation as determined by a reputable physician of the Corporation's selection. Employee hereby consents to, and agrees to make himself available for, such examination.

7.3 Termination For Cause. The Corporation may at any time during the Term, by written notice, and after affording the Employee the opportunity to be heard in person by the Board of Directors, terminate this Agreement and discharge Employee for "cause", whereupon the Corporation's obligation to pay compensation or any other amounts payable hereunder to or for the benefit of Employee shall terminate on the date of such discharge except for accrued and unpaid salary and expenses to the date of discharge. For purposes of this Agreement, the term "cause" shall mean (i) excessive absenteeism, alcoholism or drug abuse, (ii) misappropriation of, or intentional damage to, the funds, property or business of the Corporation; (iii) commission of a felony or a crime involving moral turpitude or the commission of any other act or omission involving dishonesty or fraud with respect to the Corporation or any of its affiliates; (iv) failure of the Employee to perform his duties in accordance with this Agreement after written notice to the Employee by the Board of Directors specifying such failure and giving the Employee seven (7) days to correct the defects in performance; (v) engaging in any conduct tending to bring the Corporation or any of its affiliates into public disgrace or disrepute; or (vi) breach by the Employee of any material provision hereof which, if capable of remedy, remains unremedied for more than ten (10) days after written notice.

7.4 Termination without Cause. The Corporation shall have the option to terminate this Agreement without cause upon thirty (30) days' written notice to the Employee. In the event the Corporation terminates this Agreement pursuant to this Section 7.4, the Corporation shall pay the Employee an amount equal to (a) his then accrued and unpaid base salary through and including the date of termination, and (b) the lesser of (i) the Employee's base salary for the remainder of the Term, and (ii) one (1) year of Employee's base salary. The amount payable under Subsection (b) hereof shall be paid in equal monthly installments. Upon termination of Employee's employment with the Corporation pursuant to this Section 7.4, (i) such portion of Employee's outstanding Options which have vested as of the date of termination must be exercised within 90 days of the date of termination, failing which such Options shall terminate, and (ii) the provisions of paragraph 8.3 shall be deemed of no force or effect.

7.5 Change of Control. (i) In the event of the sale or transfer of more than 50% of the outstanding shares of the Corporation, or the sale of all or substantially all of the assets of the Corporation (a "Change of Control") during the Initial Term, and (ii) the Employee's employment with the Corporation is terminated by the Corporation without cause pursuant to Section 7.4 hereof subsequent to the date of closing of the Change of Control transaction, then Employee shall be entitled to the same benefits provided in Section 7.4 above. The Employee acknowledges and agrees to execute any release or instruments required to be obtained to effectuate the closing of such Change of Control transaction.

8. Protection of Confidential Information. In view of the fact that Employee's work for the Corporation will bring him into close contact with all the confidential affairs thereof, and plans for future developments, Employee agrees to the following:

8.1 Secrecy. During the term of Employment and for two (2) years thereafter, to preserve the confidential nature of, and not disclose, reveal, or make accessible to anyone other than the Corporation's officers, directors, employees, consultants or agents, otherwise than within the scope of his employment duties and responsibilities hereunder, any and all documents, information, knowledge or data of or pertaining to the Corporation, its subsidiaries or affiliates or pertaining to any other individual, firm, corporation, partnership, joint venture, business, organization, entity or other person with which the Corporation or any of its subsidiaries or affiliates may do business during the Term of employment (including licensees, licensors, manufacturers, suppliers and customers of the Corporation or any of its subsidiaries or affiliates) and which is not in the public domain, including trade secrets, "know how", names and lists of licensees, licensors, manufacturers, suppliers and customers, programs, statistics, manufacturing and production methods, processes, techniques, pricing, marketing methods and plans, specifications, advertising plans and campaigns or any other matters, and all other confidential information of the Corporation, its subsidiaries and affiliates acquired in connection with Employee's employment (hereinafter referred to as "Confidential Information"). The restrictions on the disclosure of Confidential Information imposed by this Section 8.1 shall not apply to any Confidential Information that was part of the public domain at the time of its receipt by the Employee or becomes part of the public domain in any manner and for any reason other than an act by the Employee, unless the Employee is legally compelled (by deposition, interrogatory, request for documents, subpoena, civil investigative demand or similar process) to disclose such Confidential Information, in which event Employee shall provide the Corporation with prompt notice of such requirement so that the Corporation may seek a protective order or other appropriate remedy, and if such protective order or other remedy is not obtained, Employee shall exercise reasonable efforts in good faith to obtain assurance that confidential treatment will be accorded such Confidential Information.

8.2 Return Memoranda, etc. To deliver promptly to the Corporation on termination of his employment, or at any other time the Corporation may so request, all memoranda, notes, records, reports, manuals, drawings, blueprints and other documents (and all copies thereof) relating to the Corporation's business and all property associated therewith, which he may then possess or have under his control.

8.3 Non-competition. Provided that this Agreement has not been breached by the Corporation, the Employee agrees that he shall not at any time prior to one (1) year after the earlier to occur of (i) the expiration of the Term hereunder and (ii) the termination of his employment with the Corporation, own, manage, operate, be a director or an employee of, or a consultant to any business or corporation which is conducting any business within the generic drug industry or which competes with or conducts the same business as or similar to that conducted by the Corporation in the United States. The Employee further agrees that, provided this Agreement has not been breached by the Corporation, he shall not, at any time prior to one (1) year after the earlier to occur of (i) the expiration of the Term hereunder and (ii) the termination of his employment with the Corporation, assist or allow any such business or corporation to hire anyone who was employed by the Corporation at such time or at any time during the preceding twelve months. If any of the provisions of this section, or any part thereof, is hereinafter construed to be invalid or unenforceable, the same shall not affect the remainder of such provision or provisions, which shall be given full effect, without regard to the invalid portions. If any of the provisions of this section, or any part thereof, is held to be unenforceable because of the duration of such provision, the area covered thereby or the type of conduct restricted therein, the parties agree that the court making such determination shall have the power to modify the duration, geographic area and/or other terms of such provision and, as so modified, said provision shall then be enforceable. In the event that the courts of any one or more jurisdictions shall hold such provisions wholly or partially unenforceable by reason of the scope thereof or otherwise, it is the intention of the parties hereto that such determination not bar or in any way affect the Corporation's right to the relief provided for herein in the courts of any other jurisdictions as to breaches or threatened breaches of such provisions in such other jurisdictions, the above provisions as they relate to each jurisdiction being, for this purpose, severable into diverse and independent covenants.

8.4 Injunctive Relief. The Employee acknowledges and agrees that, because of the unique and extraordinary nature of his services, any breach or threatened breach of the provisions of Sections 8.1, 8.2, or 8.3 hereof will cause irreparable injury and incalculable harm to the Corporation, and the Corporation shall, accordingly, be entitled to injunctive and other equitable relief for such breach or threatened breach and that resort by the Corporation to such injunctive or other equitable relief shall not be deemed to waive or to limit in any respect any right or remedy which the Corporation may have with respect to such breach or threatened breach.

8.5 Expenses of Enforcement of Covenants. In the event that any action, suit or proceeding at law or in equity is brought to enforce the covenants contained in Section 8.1, 8.2, or 8.3 hereof or to obtain money damages for the breach thereof, the party prevailing in any such action, suit or other proceeding shall be entitled upon demand to reimbursement from the other party for all expenses (including, without limitation, reasonable attorneys' fees and disbursements) incurred in connection therewith.

8.6 Non-Solicitation. Employee covenants and agrees not to, directly or indirectly, during the Term of employment and for a period of two (2) years from and after the effective date of the termination of his employment with the Corporation (for any reason whatsoever), (i) induce or attempt to influence any employee of the Corporation or any of its subsidiaries or affiliates to leave its employ, or (ii) aid any person, business, or firm, including a supplier, a competitor, licensor or customer of or a manufacturer for the Corporation, in any attempt to hire any person who shall have been employed by the Corporation or any of its subsidiaries or affiliates within the period of one (1) year of the date of any such requested aid.

9. Indemnification. The Corporation will defend and indemnify Employee, to the maximum extent permitted by applicable law and the by-laws of the Corporation, against all claims, costs, charges and expenses incurred or sustained by him in connection with any action, suit or other proceeding to which he may be made a party by reason of his being an officer,

director or employee of the Corporation or of any subsidiary or affiliate thereof.

10. Employee Warranties.

Employee hereby warrants that as of the date hereof Employee is not employed (other than by the Corporation) and is not a party to any other employment contract, express or implied. Employee warrants that he has no other obligation, contractual or otherwise, which would prevent him from accepting the Corporation's offer of employment under the terms of this Agreement and from complying with its provisions. Employee warrants that he will not utilize during his employment hereunder any confidential information obtained through or in connection with his prior employment. Employee warrants that he knows of no reason why he would not be able to perform his obligations under this Agreement.

11. Notices.

All notices, requests, consents and other communications required or permitted to be given hereunder, shall be in writing and shall be deemed to have been duly given if delivered personally or sent by facsimile, with confirmation of receipt, or mailed first-class, postage prepaid, by registered or certified mail (notices sent by mail shall be deemed to have been given on the date sent), to the parties at their respective addresses hereinabove set forth or to such other address as either party shall designate by notice in writing to the other in accordance herewith.

12. General.

12.1 Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the local laws of the State of New York applicable to agreements made and to be performed entirely in New York.

12.2 Captions. The section headings contained herein are for reference purposes only and shall not in any way affect the meaning or interpretation of this Agreement.

12.3 Entire Agreement. This Agreement sets forth the entire agreement and understanding of the parties relating to the subject matter hereof, and supersedes all prior agreements, arrangements and understandings, written or oral, relating to the subject matter hereof. No representation, promise or inducement has been made by either party that is not embodied in this Agreement, and neither party shall be bound by or liable for any alleged representation, promise or inducement not so set forth.

12.4 Assignability. This Agreement, and Employee's rights and obligations hereunder, may not be assigned by Employee. The Corporation may assign its rights, together with its obligations, hereunder in connection with any sale, transfer or other disposition of all or substantially all of its business or assets; in any event the rights and obligations of the Corporation hereunder shall be binding on its successors or assigns, whether by merger, consolidation or acquisition of all or substantially all of its business or assets.

12.5 Amendment. This Agreement may be amended, modified, superseded, canceled, renewed or extended and the terms or covenants hereof may be waived, only by a written instrument executed by both of the parties hereto, or in the case of a waiver, by the party waiving compliance. No superseding instrument, amendment, modification, cancellation, renewal or extension hereof shall require the consent or approval of any person other than the parties hereto. The failure of either party at any time or times to require performance of any provision hereof shall in no matter affect the right at a later time to enforce the same. No waiver by either party of the breach of any term or covenant contained in this Agreement, whether by conduct or otherwise, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such breach, or a waiver of the breach of any other term or covenant contained in this Agreement.

12.6 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which taken together will constitute one and the same instrument.

12.7 Arbitration. Any dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted before a panel of three arbitrators, in New York, New York, in accordance with the commercial arbitration rules of the American Arbitration Association then in effect. Judgment may be entered on the arbitrator's award in any court having jurisdiction. The expense of such arbitration shall be borne as directed by the arbitrator.

12.8 Severability. The provisions of this Agreement shall be deemed severable, and if any part of any provision is held illegal, void or invalid under applicable law, such provision may be changed to the extent reasonably necessary to make the provision, as so changed, legal, valid and binding. If any provision of this Agreement is held illegal, void or invalid in its entirety, the remaining provisions of this Agreement shall not in any way be affected or impaired but shall remain binding in accordance with their terms.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

ATTEST:	HALSEY DRUG CO., INC.
_________________________	By: /s/ Michael K. Reicher -------------------------------- Michael K. Reicher, Chairman and Chief Executive Officer
WITNESS:	EMPLOYEE
___________________________	By: /s/ Vijai Kumar -------------------------------- Vijai Kumar

EXHIBIT 10.2

EXECUTIVE EMPLOYMENT AGREEMENT

EXECUTIVE EMPLOYMENT AGREEMENT (the "AGREEMENT") made as of the 26th day of August, 2003 by and between HALSEY DRUG CO., INC., a New York corporation (the "CORPORATION"), with principal executive offices at 695 North Perryville Road, Rockford, IL 61107 and ANDREW D. REDDICK, residing at 297 North Cote Circle, Exton, PA 19341 (the "EMPLOYEE").

W I T N E S S E T H

WHEREAS, the Corporation desires to employ the Employee to engage in such activities and to render such services as are required under the terms and conditions hereof and the Board of Directors has authorized and approved the execution of this Agreement; and

WHEREAS, the Employee desires to be employed by the Corporation under the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, the parties agree as follows:

1. Employment, Duties and Acceptance.

1.1 Services. The Corporation hereby employs the Employee for the Term (as hereinafter defined in Section 2 hereof), to render exclusive and full-time services to the business and affairs of the Corporation as the President and Chief Executive Officer of the Corporation, subject to the direction of the Board of Directors of the Corporation, and, in connection therewith, the Employee shall have all the duties and responsibilities customarily rendered by a President and Chief Executive Officer, and as may be further reasonably and customarily directed or requested to be performed by the Board of Directors, to which the Employee shall report, and to use his commercially reasonable best efforts, skill and abilities to promote the interests of the Corporation and its subsidiaries. The Employee's office shall be based initially and temporarily at the Corporation's Congers, New York facility. The Corporation shall use its commercially reasonable best efforts to transfer its administrative headquarters to a location in eastern Pennsylvania no more than forty-five (45) driving miles from Exton, Pennsylvania, within twelve (12) months from the date of this Agreement. Upon the completion of such transfer, the Employee shall be based at such headquarters. The Employee shall provide services to and shall travel to such of the Corporation's various offices and locations as the Corporation and the Employee mutually agree is in the best business interests of the Corporation.

1.2 Acceptance. The Employee hereby accepts such employment and agrees to render the services described in Section 1.1 hereof.

2. Term of Employment. The term of the Employee's employment under this Agreement shall commence on the date of this Agreement and shall expire two (2) years from the date hereof (the "INITIAL TERM"), unless sooner terminated pursuant to Section 7 of this Agreement; provided, however, that the Employee's term hereunder shall automatically be extended for successive one (1) year periods (each, "RENEWAL PERIOD" and together with the Initial Term, the "TERM"), unless either the Corporation or the Employee provides written notice of non-renewal of the Employee's employment with the Corporation ninety (90) days prior to the expiration of the Initial Term or any Renewal Period.

3. Compensation. In consideration of the services to be rendered by the Employee pursuant to this Agreement, the Employee shall receive from the Corporation the following compensation:

(a) Base Salary. The Corporation shall pay the Employee an aggregate base salary at the initial annual rate of $300,000 (the "BASE SALARY"), payable in equal bi-weekly installments, less such deductions or amounts to be withheld as shall be required by applicable laws and regulations. The Employee's Base Salary shall be reviewed at least annually and be subject to increase by the Board of Directors of the Corporation, in its sole and absolute discretion.

(b) Annual Bonus. During the Term, the Employee will be eligible to receive from the Corporation an annual bonus (the "BONUS") in the amount of up to thirty-five percent (35%) of the Employee's Base Salary during the fiscal year (or portion thereof) for which the Bonus may be awarded. The Bonus will be based upon on the achievement of such targets, conditions or parameters (the "BONUS CRITERIA") as will be agreed upon by the Employee and the Board of Directors or the Compensation Committee of the Board of Directors of the Corporation (i) no later than sixty (60) days from the date of this Agreement in the case of the Bonus Criteria for fiscal year 2003, and (ii) no later than sixty (60) days from the beginning of each fiscal year thereafter during the Term. The Bonus shall be paid at the same time as bonuses are paid to other executive officers, but in any event within seventy-five (75) days following the end of the Corporation's fiscal year.

4. Expenses.

The Corporation shall pay or reimburse the Employee for all reasonable expenses which are in accordance with the Corporation's expense policy in force from time to time and which are actually incurred or paid by the Employee during the Term in the performance of his services under this Agreement, upon presentation of expense statements or vouchers or such other supporting information as the Corporation may reasonably require. Such expenses shall include, but not be limited to, business travel, travel to corporate facilities and related temporary living expenses, meals and lodging, business entertainment, and travel expenses incurred by the Employee during the recruiting and interviewing process. Such expenses shall also include fees and expenses associated with membership in various business and civic associations, approved by the Compensation Committee of the Board of Directors of the Corporation, in which the Employee's participation is in the Corporation's best interest.

The Corporation shall reimburse the Employee for the legal fees and expenses incurred by the Employee for review and negotiation of this Agreement by the Employee's legal counsel up to Twelve Thousand Dollars ($12,000) on or before fifteen (15) days following the execution date of this Agreement.

5. Additional Benefits.

(a) In General. In addition to the compensation and expenses to be paid under Sections 3 and 4 hereof, the Employee will be entitled to such rights and benefits for which he may be eligible under any insurance, profit-making, incentive, bonus, stock option, stock grant or pension or retirement plan of the Corporation as the Board of Directors shall adopt from time to time in its sole and absolute discretion for the benefit of senior executives or employees generally of the Corporation.

(b) Stock Options. The Employee is hereby granted stock options to purchase 5,500,000 shares of the Corporation's common stock, $.01 par value per share (the "OPTION") at an exercise price of $.34 per share. The Option Shares shall vest and be exercisable as follows: (i) 1,000,000 Option Shares on March 31, 2004; and (ii) the balance thereafter at the rate of 500,000 Option Shares per calendar quarter (the first quarterly vesting period to be satisfied on June 30, 2004 and on each September 30, December 31, March 31, and June 30, thereafter until fully vested). The Option shall have a ten (10) year term, subject to earlier termination as set forth in Section 7 upon the termination of the Employee's employment with the Corporation and shall be evidenced by the Non-Qualified Stock Option Agreement substantially in the form of Exhibit A hereto. The Employee and the Corporation agree that the Option shall be deemed to have been issued pursuant to the Corporation's 1998 Stock Option Plan or comparable plan and the Option Shares shall be duly registered under a registration statement on Form S-8 filed with the Securities and Exchange Commission. The Employee will also be eligible in the future to receive annual option or stock grants based on performance or on achievement of milestones as determined by the Board of Directors or the Compensation Committee.

Notwithstanding the foregoing and anything to the contrary contained in this Agreement, the Employee hereby acknowledges and agrees that the grant of the Option and the issuance of the Option Shares is contingent upon approval by the shareholders of the Corporation at the next meeting of shareholders of amendments to the Corporation's 1998 Stock Option Plan (i) to increase the number of shares reserved for issuance under the 1998 Stock Option Plan and (ii) to authorize issuance of stock options (including the Option) having an exercise price less than the fair market value of the common stock of the Corporation on the date of issuance. The Corporation agrees to recommend such matter to the shareholders and to use its commercially reasonable best efforts to hold such meeting as soon as reasonably practicable, but in any event, by March 31, 2004. Upon the written request of the Employee (and following such shareholder approval), the Corporation shall promptly confirm to the Employee in writing that such contingency has been eliminated, that the Option is fully effective, and that the Option Shares have been duly registered in accordance with this Section 5(b).

(c) Purchase of Options.

In the event that the Employee is terminated for Cause (as defined in Section 7.3) during the Term or resigns other than for Good Reason (as defined in Section 7.5) during the Initial Term, the Corporation shall have the right, but not the obligation, to purchase the Employee's vested Option Shares at the Fair Market Value thereof. In the event that the Corporation does not elect to purchase the Employee's vested Option Shares within ten (10) days of the date of the Employee's termination for Cause during the Term or other than with Good Reason resignation during the Initial Term, the Employee shall be obligated to exercise his Option in writing within the later of forty (40) days of such termination or resignation or ten (10) business days after written notice of potential forfeiture from the Corporation to the Employee, failing which he shall be deemed to have forfeited his Option to the Corporation. For purposes of this Section 5(c), "FAIR MARKET VALUE" shall mean the product of (i) the positive difference, if any, between (a) the average of the closing bid and asked prices of the Corporation's Common Stock as reported by the OTC Bulletin Board (or the closing price per share of the Corporation's Common Stock as reported by such exchange or over-the-counter or other market on which the Corporation's Common Stock may then be listed or admitted for trading) for the five (5) trading days prior to the date of termination, and (b) the exercise price of the Option Shares, multiplied by (ii) the number of Option Shares, which, as of the date of termination or resignation, are vested under the Option.

6. Vacation. The Employee shall be entitled to four (4) weeks of vacation during each year of the Term, to be taken at a time or times mutually agreed upon by the Employee and the Corporation; provided, however, that not more than one (1) week of such vacation period

may be carried over to the year immediately following the year in which such vacation was to be taken, unless otherwise required by applicable law.

7. Termination.

7.1 Death. If during the Term the Employee shall die, the Employee's employment under this Agreement shall terminate as of the date of the Employee's death. Upon such termination under this Section 7.1 the Corporation shall pay to or for the benefit of the Employee to such person or persons as the Employee may designate by notice to the Corporation from time to time or, in the absence of such designation, the Employee's spouse (the "EMPLOYEE'S DESIGNEES") in a lump sum in cash within thirty (30) days from the date of the Employee's death (a) the accrued but unpaid portion of the Base Salary payable hereunder, (b) any accrued and unpaid vacation, and (c) the accrued and unpaid Bonus for such year, calculated by pro-rating the annual Bonus, which would have been payable to the Employee but for his termination under this Section 7.1 and assuming full achievement of the Bonus Criteria for such year based upon the number of days that the Employee remained in the employ of the Corporation during the year for which the Bonus is due. Additionally, notwithstanding any language to the contrary contained in any option agreements with the Employee, the Employee's Designees shall be entitled to exercise his vested option shares for twelve (12) months following the date of termination under this Section 7.1.

7.2 Disability. In the event of the Employee's "mental or physical disability" (as defined herein) which continues for (i) a period of longer than sixty (60) consecutive days, or (ii) such periods aggregating one hundred twenty (120) days during any 365 consecutive days, such that the Employee is, despite reasonable accommodation, unable to substantively perform the essential functions of his position for said periods, the determination of which shall be confirmed by the Board of Directors in the manner hereinafter provided, this Agreement shall terminate upon thirty (30) days' prior written notice to the Employee from the Corporation (the "DISABILITY TERMINATION DATE"). The Corporation shall continue to pay to the Employee during the period of his mental or physical disability the Base Salary provided in Section 3 of this Agreement as well as provide the benefits described herein; provided, however, that the Base Salary shall be reduced by any disability insurance payments paid to the Employee. On the Disability Termination Date, (a) the Employee's Base Salary shall cease, and (b) the Corporation shall pay to the Employee, in a lump sum in cash, any accrued and unpaid vacation and the accrued and unpaid Bonus for such year, calculated by pro-rating the annual Bonus, which would have been payable to the Employee but for his termination under this Section 7.2 and assuming full achievement of the Bonus Criteria for such year, based upon the number of days that the Employee remained in the employ of the Corporation during the year for which the Bonus is due. Additionally, notwithstanding any language to the contrary contained in any option agreements with the Employee, the Employee's Designees shall be entitled to exercise his vested option shares for twelve (12) months following the date of termination under this Section 7.2.

As used herein, the term "MENTALLY OR PHYSICALLY DISABLED" shall have the meaning ascribed thereto in the Corporation's disability insurance policy then in force and effect for the Employee or, if no such disability policy then exists, it shall mean the inability of the Employee, by reason of physical or mental injury, illness or other similar cause to perform the essential functions of his duties and responsibilities in connection with the conduct of the business and affairs of the Corporation as determined by a reputable physician of the Corporation's selection. The Employee hereby consents to, and agrees to make himself available for, such examination.

7.3 Termination For Cause. The Corporation may at any time during the Term, by written notice, and after affording the Employee the opportunity to be heard in person by the Board of Directors, terminate this Agreement and discharge the Employee for "Cause", whereupon the Corporation's obligation to pay compensation or any other amounts payable hereunder to or for the benefit of the Employee shall terminate on the date of such discharge except for accrued and unpaid Base Salary and expenses to the date of discharge. For purposes of this Agreement, the term "Cause" shall mean: (i) any act of the Employee's constituting willful misconduct which is materially detrimental to the Corporation's best interests, including misappropriation of, or intentional damage to, the funds, property or business of the Corporation; (ii) conviction of a felony or of a crime involving moral turpitude or conviction of any crime involving dishonesty or fraud with respect to the Corporation or any of its affiliates; (iii) material failure of the Employee to perform his duties in accordance with this Agreement after written notice to the Employee by the Board of Directors specifying such failure and giving the Employee fourteen (14) days to correct the defects in performance; or (iv) breach by the Employee of any material provision hereof which, if capable of remedy, remains unremedied for more than fourteen (14) days after written notice.

7.4 Termination Without Cause. The Corporation may terminate the Employee's employment with the Corporation at any time "Without Cause", upon thirty (30) days' written notice to the Employee. A termination "WITHOUT CAUSE" shall mean a termination by the Corporation of the Employee's employment other than due to death, disability or for Cause as provided in Sections 7.1, 7.2, and 7.3, respectively.

7.5 Termination By the Employee For Good Reason. The Employee may terminate his employment for "GOOD REASON", upon thirty (30) days' written notice to

Corporation. "GOOD REASON" shall mean a termination of employment by the Employee following, without the Employee's express prior written consent: (i) any material diminution in the Employee's duties, status, offices, reporting requirements, or job title, except in connection with termination of the Employee's employment for Cause as provided in Section 7.3 or death or disability as provided in Sections 7.1 and 7.2; (ii) any requirement by the Board that the Employee change the location at which the Employee performs his principal duties for the Corporation to a new location that is more than forty-five (45) driving miles from Exton, Pennsylvania; (iii) the failure of the Corporation timely to pay the Employee's salary, bonus or benefits due the Employee within seven (7) days of receipt of written notice from the Employee to that effect, or any material breach by the Corporation of this Agreement; (iv) any change in the Corporation's pay plan or employment agreement with the Employee that results in a material diminution of the Employee's annual Base Salary or eligible Bonus amounts; (v) the failure of the Corporation to obtain an agreement, in a form reasonably satisfactory to the Employee, from any successor to the Corporation to assume and agree to perform this Agreement; (vi) the failure of the shareholders of the Corporation, by March 31, 2004, to approve those amendments to the Corporation's 1998 Stock Option Plan described in Section 5(b) above; or (vii) the failure of Employee to be duly elected to the Board of Directors or the removal of the Employee from the Board of Directors without cause.

7.6 Payment, Benefits and Stock Options Upon Termination Without Cause Or For Good Reason.

(a) Cash Payments and Severance. In the event of a termination of the Employee's employment with the Corporation without Cause or a termination by the Employee of his employment with the Corporation for Good Reason, during the Term, the Corporation shall pay to the Employee,

(i) in a single lump sum in cash within thirty (30) days after the date of termination:

(x) the Employee's then accrued and unpaid Base Salary through and including the date of termination;

(y) the Employee's then accrued and unpaid unused vacation through and including the date of termination, and

(z) the Employee's then accrued and unpaid Bonus for such year, calculated by pro-rating the annual Bonus, which would have been payable to the Employee but for his termination and assuming full achievement of the Bonus Criteria for such year, based upon the number of days that the Employee remained in the employ of the Corporation during the year for which the Bonus is due; and

(ii) the greater of (x) the Employee's Base Salary for the remainder of the Initial Term and (y) one (1) year of the Employee's Base Salary in effect immediately prior to the date of termination ("SEVERANCE PAY"). The Severance Pay shall be paid in equal monthly installments over a twelve (12) month period commencing on the date of termination.

(b) Benefits. In addition, the Employee shall be entitled to any benefits under any employee benefit plans, and for a period of time equal to the greater of the remainder of the Initial Term or twelve (12) months from the date of termination ("SEVERANCE PERIOD"), the Employee will, at the Employee's option, (i) continue to receive all benefits to which he was entitled pursuant to Section 5(a) of this Agreement as of the date of termination including continued medical, dental, disability, and life insurance coverage for the Employee and the Employee's family, on terms substantially as in effect on the date of termination, subject to the payment by the Employee of all applicable employee contributions, or (ii) receive a lump sum payment in cash within thirty (30) days of his termination without Cause or for Good Reason representing the value of such continued benefits, plus any income tax payable by the Employee on such value. If the Employee elects option (i) above and for any reason at any time the Corporation is unable to treat the Employee as being or having been an employee of the Corporation under any benefits plan in which he is entitled to participate and as a result thereof the Employee receives reduced benefits under such plan during the period that the Employee is continuing to receive payments pursuant to this Section 7.6(b), then the Corporation shall provide the Employee with such benefits by direct payment or, at the Corporation's option, by making available equivalent benefits from other sources. During the Severance Period, the Employee shall not be entitled to receive salary and/or benefits except as provided herein and shall not be entitled to participate in any employee benefit plan of, or receive any other benefit from, the Corporation that is introduced after the date of termination, except that an appropriate adjustment shall be made if such new employee benefit or employee benefit plan is a replacement for or amendment to an employee benefit or employee benefit plan in effect as of the date of termination.

(c) Stock Options. In the event of a termination of the Employee's employment with the Corporation without Cause or a termination by the Employee of his employment with the Corporation for Good Reason, during the Term, the Corporation shall accelerate the vesting of any outstanding option to purchase shares of stock of the Corporation granted to the Employee by one (1) year, and accelerate the lapse of all repurchase rights or forfeiture restrictions applicable to any restricted stock granted to the Employee by one (1) year, such that all unvested option share or restricted shares which would have continued vesting in accordance with their vesting schedule for a period of one (1) year following the date of such termination, but for such termination, will be deemed immediately vested and exercisable. In connection therewith, the Corporation shall cause all restrictive legends, stop transfer orders or similar restrictions to be removed from such shares, except as required by applicable law. Additionally, notwithstanding any language to the contrary contained in any option agreements with the Employee, the Employee shall be entitled to exercise his vested option shares for twelve (12) months following the date of termination without Cause or for Good Reason.

7.7 Change of Control. In the event that (i) a Change of Control (as hereinafter defined) occurs during the Term and (ii) the Employee's employment with the Corporation is terminated by the Corporation other than for Cause or the Employee resigns or terminates his employment hereunder for any reason by giving sixty (60) days prior written notice to the Corporation subsequent to the date of closing of the Change of Control transaction, the Employee shall be entitled to the accrued salary, unused vacation, bonus, Severance Pay, benefits, and stock option treatment as are provided in Sections 7.6(a), (b), and (c) above, except, that (i) the Severance Pay shall be payable in a lump sum in cash within thirty (30) of the date of such termination and (ii) upon termination or resignation under this Section 7.7, the Corporation shall accelerate fully the vesting of any outstanding option to purchase shares of stock of the Corporation granted to the Employee and accelerate fully the lapse of all repurchase rights or forfeiture restrictions applicable to restricted stock granted to the Employee, such that all options shall vest in their entirety and be immediately exercisable.

For purposes of this Section 7.7, the term "CHANGE OF CONTROL" means the occurrence of any of the following, in one or a series of related transactions: (v) the sale or transfer of fifty percent (50)% or more of the Outstanding Shares of the Corporation to any person or entity other than (i) a transfer to a wholly-owned subsidiary of the Corporation or (ii) a transfer by a holder or holders of the Corporation's common stock or convertible securities as of the date hereof to Affiliates (as defined below), or (w) the sale, lease, license or other transfer of all or substantially all of the assets or earning power of the Corporation to any person or entity other than (i) a wholly-owned subsidiary of the Corporation or (ii) an Affiliate whereby the purpose or effect of such transfer is to provide for the transfer by a holder or holders of the Corporation's common stock or convertible securities as of the date hereof of such holders' direct or indirect interests in the assets of the Corporation to Affiliates and so long as such transfer does not result in a transaction described by one of the other clauses of this paragraph of Section 7.7; or (x) merger, consolidation, reorganization, recapitalization, share exchange, business combination or a similar transaction which results in any person or entity (other than the persons who are shareholders or security holders of the Corporation immediately prior to such transaction (or their Affiliates as of the date of such transaction)) owning fifty percent (50%) or more of the Outstanding Shares or combined voting power of the Corporation, (y) merger, consolidation, reorganization, business combination or a similar transaction in which the Corporation is not the surviving entity; or (z) a transaction commonly known as "going private" whereby the Corporation engages one or a series of transactions which results in the Corporation not being required to file periodic reports with the Securities and Exchange Commission, unless the Employee is a participant in such transaction. "OUTSTANDING SHARES" shall mean the total number of common shares and common share equivalents of the Corporation outstanding at the time the Change of Control. "AFFILIATE" shall mean (i) any person or entity controlling, controlled by or under the common control of the existing holders of common stock or convertible securities of the Corporation and (ii) any partner, shareholder or member of the existing holders of common stock or convertible securities of the Corporation. For the purposes hereof, "CONTROL" shall mean the direct or indirect ownership of at least fifty (50%) percent of the outstanding shares or other voting rights of the subject entity or if it possesses, directly or indirectly, the power to direct or cause the direction of management and policies of such other entity.

In the event that the Employee resigns or terminates his employment following a Change of Control as described above, the Employee acknowledges and agrees that upon the request of the Corporation, he will execute and deliver a release in customary form releasing all claims of the Employee arising out of his employment with the Corporation except for the obligations of the Corporation under this Agreement.

8. Protection of Confidential Information. In view of the fact that the Employee's work for the Corporation will bring him into close contact with all the confidential affairs thereof, and plans for future developments, the Employee agrees to the following:

8.1 Secrecy. During the Term and for five (5) years after the date of termination of the Employee's employment, to preserve the confidential nature of, and not disclose, reveal, or make accessible to anyone other than the Corporation's officers, directors, employees, consultants or agents, otherwise than within the scope of his employment duties and responsibilities hereunder, any and all documents, information, knowledge or data of or pertaining to the Corporation, its subsidiaries or affiliates or pertaining to any other individual, firm, corporation, partnership, joint venture, business, organization, entity or other person with which the Corporation or any of its subsidiaries or affiliates may do business during the Term (including licensees, licensors, manufacturers, suppliers and customers of the Corporation or any of its subsidiaries or affiliates) and which is not in the public domain, including trade secrets, "know how", names and lists of licensees, licensors, manufacturers, suppliers and customers, development plans or programs, statistics, manufacturing and production methods, processes, techniques, pricing, marketing methods and plans, specifications, advertising plans and campaigns or any other matters, and all other confidential information of the Corporation, its subsidiaries and affiliates (hereinafter referred to as "CONFIDENTIAL INFORMATION"). The restrictions on the disclosure of Confidential Information imposed by this Section 8.1 shall not apply to any Confidential Information that was part of the public domain at the time of its receipt by the Employee or becomes part of the public domain in any manner and for any reason other than an act by the Employee, unless the Employee is legally compelled (by applicable law, deposition, interrogatory, request for documents, subpoena, civil investigative demand or similar process) to disclose such Confidential Information, in which event the Employee shall provide the Corporation with prompt notice of such requirement so that the Corporation may seek a protective order or other appropriate remedy, and if such protective order or other remedy is not obtained, the Employee shall exercise reasonable efforts in good faith to obtain assurance that confidential treatment will be accorded such Confidential Information.

8.2 Return Memoranda, etc. To deliver promptly to the Corporation on termination of his employment, or at any other time the Corporation may so request, all memoranda, notes, records, reports, manuals, drawings, blueprints and other documents (and all copies thereof) relating to the Corporation's business and all property associated therewith, which the Employee may then possess or have under his control.

8.3 Non-competition. Provided that this Agreement has not been breached by the Corporation, the Employee agrees that he shall not at any time prior to one (1) year after the expiration or termination of his employment with the Corporation, own, manage, operate, be a director or an employee of, or a consultant to any person, business, corporation, partnership, trust, limited liability company or other firm or enterprise ("PERSON") which is engaged in marketing, selling or distributing products or in developing product candidates in the United States which are directly competitive with products or product candidates in development as evidenced by the current written product development plan and/or business plan of the Corporation at the time of termination of the Employee's employment and/or described in the Corporation's most recent filing on Form 10-K with the Securities and Exchange Commission as of the date of the termination of the Employee's employment.

If any of the provisions of this section, or any part thereof, is hereinafter construed to be invalid or unenforceable, the same shall not affect the remainder of such provision or provisions, which shall be given full effect, without regard to the invalid portions. If any of the provisions of this section, or any part thereof, is held to be unenforceable because of the duration of such provision, the area covered thereby or the type of conduct restricted therein, the parties agree that the court making such determination shall have the power to modify the duration, geographic area and/or other terms of such provision and, as so modified, said provision shall then be enforceable. In the event that the courts of any one or more jurisdictions shall hold such provisions wholly or partially unenforceable by reason of the scope thereof or otherwise, it is the intention of the parties hereto that such determination not bar or in any way affect the Corporation's right to the relief provided for herein in the courts of any other jurisdictions as to breaches or threatened breaches of such provisions in such other jurisdictions, the above provisions as they relate to each jurisdiction being, for this purpose, severable into diverse and independent covenants.

8.4 Injunctive Relief. The Employee acknowledges and agrees that, because of the unique and extraordinary nature of his services, any breach or threatened breach of the provisions of Sections 8.1, 8.2, or 8.3 hereof will cause irreparable injury and incalculable harm to the Corporation, and the Corporation shall, accordingly, be entitled to injunctive and other equitable relief for such breach or threatened breach and that resort by the Corporation to such injunctive or other equitable relief shall not be deemed to waive or to limit in any respect any right or remedy which the Corporation may have with respect to such breach or threatened breach.

8.5 Expenses of Enforcement of Covenants. In the event that any action, suit or proceeding at law or in equity is brought to enforce the covenants contained in Section 8.1, 8.2, or 8.3 hereof or to obtain money damages for the breach thereof, the party prevailing in any such action, suit or other proceeding shall be entitled upon demand to reimbursement from the other party for all expenses (including, without limitation, reasonable attorneys' fees and disbursements) incurred in connection therewith.

8.6 Non-Solicitation. The Employee covenants and agrees not to (and not to cause or direct any Person to) hire or solicit for employment any employee of the Corporation or any of its subsidiaries or affiliates. The prohibitions of this Section 8.6 shall apply (i) for six (6) months following the termination of the Employee's employment by the Corporation without Cause or by the Employee for Good Reason, prior to a Change of Control, (ii) for twelve (12) months following the termination of the Employee's employment for Cause, prior to a Change of Control, or (iii) twenty-four (24) months following a Change of Control.

9. Indemnification. The Corporation will defend, indemnify and hold harmless the Employee, to the maximum extent permitted by applicable law and the by-laws of the Corporation, against all claims, costs, charges and expenses incurred or sustained by him in connection with any action, suit or other proceeding to which he may be made a party by reason

of his being an officer, director or employee of the Corporation or of any subsidiary or affiliate thereof. Furthermore, the Corporation hereby represents that it will maintain during the Term, Directors and Officers insurance coverage in the amount of at least Five Million Dollars ($5,000,000).

10. Warranties.

The Employee hereby warrants that as of the date hereof the Employee is not employed (other than by the Corporation) and is not a party to any other employment contract, express or implied. The Employee warrants that he has no other obligation, contractual or otherwise, which would prevent him from accepting the Corporation's offer of employment under the terms of this Agreement and from complying with its provisions. The Employee warrants that he will not utilize during his employment hereunder any confidential information obtained through or in connection with his prior employment. The Employee warrants that he knows of no reason why he would not be able to perform his obligations under this Agreement. The Employee warrants that he has duly executed and delivered this Agreement and it is valid, binding and enforceable against the Employee in accordance with its terms. The Corporation warrants to the Employee that this Agreement has been duly approved and authorized by its Board of Directors, that this Agreement has been duly executed and delivered on behalf of the Corporation and that this Agreement is valid, binding and enforceable against the Corporation in accordance with its terms.

11. Notices.

All notices, requests, consents and other communications required or permitted to be given hereunder, shall be in writing and shall be deemed to have been duly given if delivered personally or sent by facsimile, with confirmation of receipt, or mailed first-class, postage prepaid, by registered or certified mail (notices sent by mail shall be deemed to have been given three (3) business days after the date sent), to the parties at their respective addresses hereinabove set forth or to such other address as either party shall designate by notice in writing to the other in accordance herewith.

12. General.

12.1 Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the local laws of the Commonwealth of New York applicable to agreements made and to be performed entirely in New York.

12.2 Captions. The section headings contained herein are for reference purposes only and shall not in any way affect the meaning or interpretation of this Agreement.

12.3 Entire Agreement. This Agreement sets forth the entire agreement and understanding of the parties relating to the subject matter hereof, and supersedes all prior agreements, arrangements and understandings, written or oral, relating to the subject matter hereof. No representation, promise or inducement has been made by either party that is not embodied in this Agreement, and neither party shall be bound by or liable for any alleged representation, promise or inducement not so set forth.

12.4 Nomination to the Board of Directors. During the Term, the Corporation shall cause the Employee to be nominated for election to the Board of Directors of the Corporation at each Annual Meeting of shareholders of the Corporation, and at each special meeting of the shareholders of the Corporation called for the purpose of electing directors of the Corporation and at any time at which the shareholders of the Corporation have the right to elect directors of the Corporation, and shall recommend that the Corporation's shareholders vote in favor of the election of the Employee to the Board of Directors.

12.5 Assignability. This Agreement, and the Employee's rights and obligations hereunder, may not be assigned by the Employee. The Corporation may assign its rights, together with its obligations, hereunder in connection with any sale, transfer or other disposition of all or substantially all of its business or assets; in any event the rights and obligations of the Corporation hereunder shall be binding on its successors or assigns, whether by merger, consolidation or acquisition of all or substantially all of its business or assets.

12.6 Amendment. This Agreement may be amended, modified, superseded, canceled, renewed or extended and the terms or covenants hereof may be waived, only by a written instrument executed by both of the parties hereto, or in the case of a waiver, by the party waiving compliance. No superseding instrument, amendment, modification, cancellation, renewal or extension hereof shall require the consent or approval of any person other than the parties hereto. The failure of either party at any time or times to require performance of any provision hereof shall in no manner affect the right at a later time to enforce the same. No waiver by either party of the breach of any term or covenant contained in this Agreement, whether by conduct or otherwise, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such breach, or a waiver of the breach of any other term or covenant contained in this Agreement.

12.7 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which taken together will constitute one and the same instrument.

12.8 Severability. The provisions of this Agreement shall be deemed severable, and if any part of any provision is held illegal, void or invalid under applicable law, such provision may be changed to the extent reasonably necessary to make the provision, as so changed, legal, valid and binding. If any provision of this Agreement is held illegal, void or invalid in its entirety, the remaining provisions of this Agreement shall not in any way be affected or impaired but shall remain binding in accordance with their terms.

[SIGNATURE PAGE TO FOLLOW]

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

ATTEST:	HALSEY DRUG CO., INC.
______________________________	By: /s/ Jerry Karabelas -------------------------------- Name: Jerry Karabelas, Title: Chairman of the Board
WITNESS:	EMPLOYEE
______________________________	By: /s/ Andrew D. Reddick -------------------------------- ANDREW D. REDDICK

EXHIBIT 10.3

EXECUTIVE EMPLOYMENT AGREEMENT

EXECUTIVE EMPLOYMENT AGREEMENT (the "AGREEMENT") made as of the 5th day of April, 2004 by and between HALSEY DRUG CO., INC., a New York corporation (the "CORPORATION"), with administrative offices at 616 N. North Court, Suite 120, Palatine, IL 60067 and RON J. SPIVEY, residing at 3514 Bimini Avenue, Cooper City, Florida 33026 (the "EMPLOYEE").

W I T N E S S E T H

WHEREAS, the Corporation desires to employ the Employee to engage in such activities and to render such services as are required under the terms and conditions hereof and the Board of Directors has authorized and approved the execution of this Agreement; and

WHEREAS, the Employee desires to be employed by the Corporation under the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, the parties agree as follows:

1. Employment, Duties and Acceptance.

1.1 Services. The Corporation hereby employs the Employee for the Term (as hereinafter defined in Section 2 hereof), to render exclusive and full-time services to the business and affairs of the Corporation as the Senior Vice President and Chief Scientific Officer of the Corporation, subject to the direction of the Corporation's Chief Executive Officer ("CEO") and the Board of Directors of the Corporation, and, in connection therewith, the Employee shall have all the duties and responsibilities customarily rendered by a Senior Vice President and Chief

Scientific Officer, including, without limitation, the leadership and implementation of all Corporation scientific projects, with primary focus on the Corporation's abuse deterrent formulation technology and active pharmaceutical ingredient process technology, and such other tasks as may be further reasonably and customarily directed or requested to be performed by the CEO, to whom the Employee shall report, and to use his commercially reasonable best efforts, skill and abilities to promote the interests of the Corporation and its subsidiaries. The Employee shall perform the services as Senior Vice President and Chief Scientific Officer at his home office as well as by travelling to the Corporation's Culver, Indiana facility and Palatine, Illinois offices and such other locations as shall be designated by the CEO from time to time, including, without limitation, the locations of contract research organizations, clinical trial sites, and such other locations as shall be required for meetings or presentations with prospective investors, counsel, prospective partners and other locations as the CEO shall determine to be in the best business interests of the Corporation.

1.2 Acceptance. The Employee hereby accepts such employment and agrees to render the services described in Section 1.1 hereof.

2. Term of Employment. The term of the Employee's employment under this Agreement shall commence on the date of this Agreement and shall expire two (2) years from the date hereof (the "INITIAL TERM"), unless sooner terminated pursuant to Section 7 of this Agreement; provided, however, that the Employee's term hereunder shall automatically be extended for successive one (1) year periods (each, "RENEWAL PERIOD" and together with the Initial Term, the "TERM"), unless either the Corporation or the Employee provides written notice of non-renewal of the Employee's employment with the Corporation ninety (90) days prior to the expiration of the Initial Term or any Renewal Period.

3. Compensation. In consideration of the services to be rendered by the Employee pursuant to this Agreement, the Employee shall receive from the Corporation the following compensation:

(a) Base Salary. The Corporation shall pay the Employee an aggregate base salary at the initial annual rate of $260,000 (the "BASE SALARY"), payable in equal bi-weekly installments, less such deductions or amounts to be withheld as shall be required by applicable laws and regulations. The Employee's Base Salary shall be reviewed at least annually and be subject to increase by the Board of Directors of the Corporation, in its sole and absolute discretion.

(b) Annual Bonus. During the Term, the Employee will be eligible to receive from the Corporation an annual bonus (the "BONUS") in the amount of up to thirty-five percent (35%) of the Employee's Base Salary during the fiscal year (or portion thereof) for which the Bonus may be awarded. The Bonus will be based upon on the achievement of such targets, conditions or parameters (the "BONUS CRITERIA") as will be agreed upon by the Employee and the Board of Directors or the Compensation Committee of the Board of Directors of the Corporation (i) no later than sixty (60) days from the date of this Agreement in the case of the Bonus Criteria for fiscal year 2004, and (ii) no later than sixty (60) days from the beginning of each fiscal year thereafter during the Term. The Bonus shall be paid at the same time as bonuses are paid to other executive officers, but in any event within seventy-five (75) days following the end of the Corporation's fiscal year.

4. Expenses.

The Corporation shall pay or reimburse the Employee for all reasonable expenses which are in accordance with the Corporation's expense policy in force from time to time and which are actually incurred or paid by the Employee during the Term in the performance of his services under this Agreement, upon presentation of expense statements or vouchers or such other supporting information as the Corporation may reasonably require. Such expenses shall include, but not be limited to, business travel, travel to corporate facilities and related temporary living expenses, meals and lodging, and business entertainment. Such expenses shall also include fees and expenses associated with membership in various business and civic associations, approved in advance by the Compensation Committee of the Board of Directors of the Corporation, in which the Employee's participation is in the Corporation's best interest.

5. Additional Benefits.

(a) In General. In addition to the compensation and expenses to be paid under Sections 3 and 4 hereof, the Employee will be entitled to such rights and benefits for which he may be eligible under any insurance, profit-making, incentive, bonus, stock option, stock grant or pension or retirement plan of the Corporation as the Board of Directors shall adopt from time to time in its sole and absolute discretion for the benefit of senior executives or employees generally of the Corporation.

(b) Stock Options. Upon execution of this Agreement, the Employee is hereby granted stock options to purchase 3,000,000 shares of the Corporation's common stock, $.01 par value per share (the "OPTION") at an exercise price of $0.13 per share. The Option shares shall vest and be exercisable as follows: (i) 1,000,000 Option shares on October 1, 2004; and (ii) the balance at the rate of 333,333 per calendar quarter, beginning January 1, 2005 . The Option shall have a ten (10) year term, subject to earlier termination as set forth in Section 7 upon the termination of the Employee's employment with the Corporation and shall be evidenced by the Non-Qualified Stock Option Agreement substantially in the form of Exhibit A hereto. The Employee and the Corporation agree that the Option shall be deemed to have been issued pursuant to the Corporation's 1998 Stock Option Plan or comparable plan and the Corporation shall use commercially reasonable best efforts to register the Option Shares under the Securities Act of 1933, as amended, under a registration statement on Form S-8 filed with the Securities and Exchange Commission. The Employee will also be eligible in the future to receive option grants based on performance or on achievement of milestones as determined by the Board of Directors or the Compensation Committee.

Notwithstanding the foregoing and anything to the contrary contained in this Agreement, the Employee hereby acknowledges and agrees that the grant of the Option and the issuance of the shares underlying the Option are contingent upon approval by the shareholders of the Corporation at the next meeting of the Corporation's shareholders of amendments to the Corporation's 1998 Stock Option Plan (i) to increase the number of shares reserved for issuance under the 1998 Stock Option Plan, and (ii) to authorize issuance of stock options (including the Option) having an exercise price less than the fair market value of the common stock of the Corporation on the date of issuance. The Corporation agrees to recommend such matter to the shareholders and to use its commercially reasonable best efforts to hold such meeting as soon as reasonably practicable, but in any event, by December 31, 2004. Upon the written request of the Employee (and following such shareholder approval), the Corporation shall promptly confirm to the Employee in writing that such contingency has been eliminated and that the Option is fully effective, and the date the shares underlying the Option have been duly registered in accordance with this Section 5(b).

(c) Purchase of Options.

In the event that during the Term the Employee is terminated for Cause (as defined in Section 7.3) or resigns other than for Good Reason (as defined in Section 7.5), the Corporation shall have the right, but not the obligation, to purchase the Employee's vested shares under any outstanding stock options issued by the Corporation to the Employee (including, without limitation, the Option) at the Fair Market Value thereof. In the event that the Corporation does not elect to purchase the Employee's vested option shares within ten (10) days of the date of (i) the Employee's termination for Cause, or (ii) Employee's resignation, other than with Good Reason, the Employee shall be obligated to exercise his options in writing within forty (40) days of such termination or resignation failing which he shall be deemed to have forfeited his Option to the Corporation. For purposes of this Section 5(c), "FAIR MARKET VALUE" shall mean the product of (i) the positive difference, if any, between (a) the average of the closing bid and asked prices of the Corporation's Common Stock as reported by the OTC Bulletin Board (or the closing price per share of the Corporation's Common Stock as reported by such exchange or over-the-counter or other market on which the Corporation's Common Stock may then be listed or admitted for trading) for the five (5) trading days prior to the date of termination or resignation, as applicable, and (b) the exercise price of the option shares, multiplied by (ii) the number of option shares, which, as of the date of termination or resignation, are vested under the options.

6. Vacation. The Employee shall be entitled to four (4) weeks of vacation during each year of the Term, to be taken at a time or times mutually agreed upon by the Employee and the Corporation; provided, however, that not more than one (1) week of such vacation period

may be carried over to the year immediately following the year in which such vacation was to be taken, unless otherwise required by applicable law.

7. Termination.

7.1 Death. If during the Term the Employee shall die, the Employee's employment under this Agreement shall terminate as of the date of the Employee's death. Upon such termination under this Section 7.1 the Corporation shall pay in equal portions to Dawn Spivey and Darin Spivey (the "Employee's Designees"), in a lump sum in cash within thirty (30) days from the date of the Employee's death (a) the accrued but unpaid portion of the Base Salary payable hereunder, and (b) any accrued and unpaid vacation. Additionally, notwithstanding any language to the contrary contained in any option agreements with the Employee, the Employee's Designees shall be entitled to exercise the Employee's vested option shares during the twelve (12) months following the date of termination under this Section 7.1. At the expiration of such twelve (12) month period, the options shall terminate.

7.2 Disability. In the event of the Employee's "mental or physical disability" (as defined herein) which continues for (i) a period of longer than sixty (60) consecutive days, or (ii) such periods aggregating one hundred twenty (120) days during any 365 consecutive days, such that the Employee is, despite reasonable accommodation, unable to substantively perform the essential functions of his position for said periods, the determination of which shall be confirmed by the Board of Directors in the manner hereinafter provided, this Agreement shall terminate upon thirty (30) days' prior written notice to the Employee from the Corporation (the "DISABILITY TERMINATION DATE"). The Corporation shall continue to pay to the Employee during the period of his mental or physical disability the Base Salary provided in Section 3 of this Agreement as well as provide the benefits described herein; provided, however, that the Base

Salary shall be reduced by any disability insurance payments paid to the Employee. On the Disability Termination Date, (a) the Employee's Base Salary shall cease, and (b) the Corporation shall pay to the Employee, in a lump sum in cash, any accrued and unpaid vacation. Additionally, notwithstanding any language to the contrary contained in any option agreements with the Employee, the Employee's Designees shall be entitled to exercise his vested option shares for twelve (12) months following the date of termination under this Section 7.2. At the expiration of such twelve (12) month period, the options shall terminate.

As used herein, the term "MENTALLY OR PHYSICALLY DISABLED" shall have the meaning ascribed thereto in the Corporation's disability insurance policy then in force and effect for the Employee or, if no such disability policy then exists, it shall mean the inability of the Employee, by reason of physical or mental injury, illness or other similar cause to perform the essential functions of his duties and responsibilities in connection with the conduct of the business and affairs of the Corporation as determined by a reputable physician of the Corporation's selection. The Employee hereby consents to, and agrees to make himself available for, such examination.

7.3 Termination For Cause. The Corporation may at any time during the Term, by written notice, and after affording the Employee the opportunity to be heard in person by the Board of Directors, terminate this Agreement and discharge the Employee for "Cause", whereupon the Corporation's obligation to pay compensation or any other amounts payable hereunder to or for the benefit of the Employee shall terminate on the date of such discharge except for accrued and unpaid Base Salary and expenses to the date of discharge. For purposes of this Agreement, the term "Cause" shall mean: (i) any act of the Employee's constituting willful misconduct which is materially detrimental to the Corporation's best interests, including misappropriation of, or intentional damage to, the funds, property or business of the Corporation; (ii) conviction of a felony or of a crime involving moral turpitude or conviction of any crime involving dishonesty or fraud with respect to the Corporation or any of its affiliates; (iii) material failure of the Employee to perform his duties in accordance with this Agreement after written notice to the Employee by the Board of Directors specifying such failure and giving the Employee fourteen (14) days to correct the defects in performance; or (iv) breach by the Employee of any material provision hereof which, if capable of remedy, remains unremedied for more than fourteen (14) days after written notice.

7.4 Termination Without Cause. The Corporation may terminate the Employee's employment with the Corporation at any time "without Cause", upon thirty (30) days' written notice to the Employee. A termination "WITHOUT CAUSE" shall mean a termination of the Employee's employment other than due to death, disability or for Cause as provided in Sections 7.1, 7.2, and 7.3, respectively.

7.5 Termination By the Employee For Good Reason. The Employee may terminate his employment for "GOOD REASON", upon thirty (30) days' written notice to Corporation. "GOOD REASON" shall mean a termination of employment by the Employee following, without the Employee's express prior written consent: (i) any material diminution in the Employee's duties, status, offices, reporting requirements, or job title, except in connection with termination of the Employee's employment for Cause as provided in Section 7.3 or death or disability as provided in Sections 7.1 and 7.2; (ii) the failure of the Corporation timely to pay the Employee's salary, bonus or benefits due the Employee or any material breach by the Corporation of this Agreement, in each case within ten (10) days of the Corporation's receipt of written notice from the Employee to that effect, which remains uncured at the end of such ten

(10) day period; (iii) any change in the Corporation's pay plan or employment agreement with the Employee that results in a material diminution of the Employee's annual Base Salary or eligible Bonus amounts; (iv) the failure of the Corporation to obtain an agreement from any successor to the Corporation to assume and agree to perform this Agreement; or (v) a Change of Control of the Corporation, as defined in Section 7.7.

7.6 Payment, Benefits and Stock Options Upon Termination Without Cause Or For Good Reason.

(a) Cash Payments and Severance. In the event of a termination by the Corporation of the Employee's employment with the Corporation without Cause or a termination by the Employee of his employment with the Corporation for Good Reason, during the Term, the Corporation shall pay to the Employee,

(i) in a single lump sum in cash within thirty (30) days after the date of termination:

(x) the Employee's then accrued and unpaid Base Salary through and including the date of termination;

(y) the Employee's then accrued and unpaid unused vacation through and including the date of termination, and

(z) the Employee's then accrued and unpaid Bonus for such year, calculated by pro-rating the annual Bonus, which would have been payable to the Employee but for his termination and assuming full achievement of the Bonus Criteria for such year, based upon the number of days that the Employee remained in the employ of the Corporation during the year for which the Bonus is due; and

(ii) one (1) year of the Employee's Base Salary in effect immediately prior to the date of termination ("SEVERANCE PAY"). The Severance Pay shall be paid in equal monthly installments over the Severance Period (as defined in

Section 7.6(b) below) commencing on the date of termination.

(b) Benefits. In addition, the Employee shall be entitled to any benefits under any employee benefit plans, and for twelve (12) months from the date of termination ("SEVERANCE PERIOD"), the Employee will, at the Employee's option, (i) continue to receive all benefits to which he was entitled pursuant to Section 5(a) of this Agreement as of the date of termination including continued medical, dental, disability, and life insurance coverage for the Employee and the Employee's family, on terms substantially as in effect on the date of termination, subject to the payment by the Employee of all applicable employee contributions, or (ii) receive a lump sum payment in cash within thirty (30) days of his termination without Cause or for Good Reason representing the value of such continued benefits, plus any income tax payable by the Employee on such value. If the Employee elects option (i) above and for any reason at any time the Corporation is unable to treat the Employee as being or having been an employee of the Corporation under any benefits plan in which he is entitled to participate and as a result thereof the Employee receives reduced benefits under such plan during the period that the Employee is continuing to receive payments pursuant to this Section 7.6(b), then the Corporation shall provide the Employee with such benefits by direct payment or, at the Corporation's option, by making available equivalent benefits from other sources. During the Severance Period, the Employee shall not be entitled to receive salary and/or benefits except as provided herein and shall not be entitled to participate in any employee benefit plan of, or receive any other benefit from, the Corporation that is introduced after the date of termination, except that an appropriate adjustment shall be made if such new employee benefit or employee benefit plan is a replacement for or amendment to an employee benefit or employee benefit plan in effect as of the date of termination.

(c) Stock Options. In the event of a termination of the Employee's employment with the Corporation without Cause or a termination by the Employee of his employment with the Corporation for Good Reason, during the Term, the Corporation shall accelerate the vesting of any outstanding option to purchase shares of stock of the Corporation granted to the Employee by one (1) year, and accelerate the lapse of all repurchase rights or forfeiture restrictions applicable to any restricted stock granted to the Employee by one (1) year, such that all unvested option shares or restricted shares which would have continued vesting in accordance with their vesting schedule for a period of one (1) year following the date of such termination, but for such termination, will be deemed immediately vested and exercisable. In connection therewith, the Corporation shall cause all restrictive legends, stop transfer orders or similar restrictions to be removed from such shares, except as required by applicable law. Additionally, notwithstanding any language to the contrary contained in any option agreements with the Employee, the Employee shall be entitled to exercise his vested option shares for twelve (12) months following the date of termination without Cause or resignation for Good Reason. At the expiration of such twelve (12) month period, all options shall terminate.

7.7 Change of Control. In the event that (i) a Change of Control (as hereinafter defined) occurs during the Term and (ii) the Employee's employment with the Corporation is terminated by the Corporation without Cause or the Employee resigns or terminates his employment hereunder for Good Reason, the Employee shall be entitled to the accrued salary, unused vacation, bonus, Severance Pay, benefits, and stock option treatment as are provided in Sections 7.6(a), (b), and (c) above, except, that (i) the Severance Pay shall be payable in a lump sum in cash within thirty (30) of the date of such termination, and (ii) upon termination or resignation under this Section 7.7, the Corporation shall accelerate fully the vesting of any outstanding option to purchase shares of stock of the Corporation granted to the Employee and accelerate fully the lapse of all repurchase rights or forfeiture restrictions applicable to restricted stock granted to the Employee, such that all options shall vest in their entirety and be immediately exercisable. The Employee shall give the Corporation not less than sixty (60) days' prior written notice of a termination of employment with the Corporation following a Change of Control transaction.

For purposes of this Section 7.7, the term "CHANGE OF CONTROL" means the occurrence of any of the following, in one or a series of related transactions: (v) the sale or transfer of fifty percent (50)% or more of the Outstanding Shares of the Corporation to any person or entity other than (i) a transfer to a wholly-owned subsidiary of the Corporation, (ii) a transfer by a holder or holders of the Corporation's common stock or convertible securities as of the date hereof to Affiliates (as defined below), or (iii) the conversion of the Corporation's debentures outstanding as of the date hereof into preferred stock or the conversion of such preferred stock into common stock, or (w) the sale, lease or other transfer of all or substantially all of the assets or earning power of the Corporation to any person or entity other than (i) a wholly-owned subsidiary of the Corporation, (ii) an Affiliate whereby the purpose or effect of such transfer is to provide for the transfer by a holder or holders of the Corporation's common stock or convertible securities as of the date hereof of such holders' direct or indirect interests in the assets of the Corporation to Affiliates and so long as such transfer does not result in a transaction described by one of the other clauses of this paragraph of Section 7.7, or (iii) the sale, lease, license or transfer of the Corporation's assets located in Congers, New York, including without limitation, intellectual property, inventory, equipment, regulatory approvals and related assets, to a third-party purchaser; or (x) merger, consolidation, reorganization, recapitalization, share exchange, business combination or a similar transaction which results in any person or entity (other than the persons who are shareholders or security holders of the Corporation immediately prior to such transaction (or their Affiliates as of the date of such transaction)) owning fifty percent (50%) or more of the Outstanding Shares or combined voting power of the Corporation, (y) merger, consolidation, reorganization, business combination or a similar transaction in which the Corporation is not the surviving entity; or (z) a transaction commonly known as "going private" whereby the Corporation engages one or a series of transactions which results in the Corporation not being required to file periodic reports with the Securities and Exchange Commission, unless the Employee is a participant in such transaction. "OUTSTANDING SHARES" shall mean the total number of common shares and common share equivalents of the Corporation outstanding at the time the Change of Control, including, without limitation, shares of common stock underlying debentures, preferred stock, options, warrants and other convertible securities. "AFFILIATE" shall mean (i) any person or entity controlling, controlled by or under the common control of the existing holders of common stock or convertible securities of the Corporation and (ii) any partner, shareholder or member of the existing holders of common stock or convertible securities of the Corporation. For the purposes hereof, "CONTROL" shall mean the direct or indirect ownership of at least fifty (50%) percent of the outstanding shares or other voting rights of the subject entity or if it possesses, directly or indirectly, the power to direct or cause the direction of management and policies of such other entity.

In the event that the Employee resigns or terminates his employment following a Change of Control as described above, the Employee acknowledges and agrees that upon the request of the Corporation, he will execute and deliver a release in customary form releasing all claims of the Employee arising out of his employment with the Corporation except for the obligations of the Corporation under this Agreement.

8. Protection of Confidential Information. In view of the fact that the Employee's work for the Corporation will bring him into close contact with all the confidential affairs thereof, and plans for future developments, the Employee agrees to the following:

8.1 Secrecy. During the Term and for five (5) years after the date of termination of the Employee's employment, to preserve the confidential nature of, and not disclose, reveal, or make accessible to anyone other than the Corporation's officers, directors, employees, consultants or agents, otherwise than within the scope of his employment duties and responsibilities hereunder, any and all documents, information, knowledge or data of or pertaining to the Corporation, its subsidiaries or affiliates or pertaining to any other individual, firm, corporation, partnership, joint venture, business, organization, entity or other person with which the Corporation or any of its subsidiaries or affiliates may do business during the Term (including licensees, licensors, manufacturers, suppliers and customers of the Corporation or any of its subsidiaries or affiliates) and which is not in the public domain, including trade secrets, "know how", names and lists of licensees, licensors, manufacturers, suppliers and customers, development plans or programs, statistics, manufacturing and production methods, processes, techniques, pricing, marketing methods and plans, specifications, advertising plans and campaigns or any other matters, and all other confidential information of the Corporation, its subsidiaries and affiliates (hereinafter referred to as "CONFIDENTIAL INFORMATION"). The restrictions on the disclosure of Confidential Information imposed by this Section 8.1 shall not apply to any Confidential Information that was part of the public domain at the time of its receipt by the Employee or becomes part of the public domain in any manner and for any reason other than an act by the Employee, unless the Employee is legally compelled (by applicable law, deposition, interrogatory, request for documents, subpoena, civil investigative demand or similar process) to disclose such Confidential Information, in which event the Employee shall provide the Corporation with prompt notice of such requirement so that the Corporation may seek a protective order or other appropriate remedy, and if such protective order or other remedy is not obtained, the Employee shall exercise reasonable efforts in good faith to obtain assurance that confidential treatment will be accorded such Confidential Information.

8.2 Return Memoranda, etc. To deliver promptly to the Corporation on termination of his employment, or at any other time the Corporation may so request, all memoranda, notes, records, reports, manuals, drawings, blueprints and other documents (and all copies thereof) relating to the Corporation's business and all property associated therewith, which the Employee may then possess or have under his control.

8.3 Non-competition. Provided that this Agreement has not been breached by the Corporation, the Employee agrees that he shall not at any time prior to one (1) year after the expiration or termination of his employment with the Corporation, own, manage, operate, be a director or an employee of, or a consultant to any person, business, corporation, partnership, trust, limited liability company or other firm or enterprise ("PERSON") which is engaged in marketing, selling or distributing products or in developing product candidates in the United States which are directly competitive with products or product candidates in development as evidenced by the current written product development plan and/or business plan of the Corporation at the time of termination of the Employee's employment and/or described in the Corporation's most recent filing on Form 10-K with the Securities and Exchange Commission as of the date of the termination of the Employee's employment.

If any of the provisions of this section, or any part thereof, is hereinafter construed to be invalid or unenforceable, the same shall not affect the remainder of such provision or provisions, which shall be given full effect, without regard to the invalid portions. If any of the provisions of this section, or any part thereof, is held to be unenforceable because of the duration of such provision, the area covered thereby or the type of conduct restricted therein, the parties agree that the court making such determination shall have the power to modify the duration, geographic area and/or other terms of such provision and, as so modified, said provision shall then be enforceable. In the event that the courts of any one or more jurisdictions shall hold such provisions wholly or partially unenforceable by reason of the scope thereof or otherwise, it is the intention of the parties hereto that such determination not bar or in any way affect the Corporation's right to the relief provided for herein in the courts of any other jurisdictions as to breaches or threatened breaches of such provisions in such other jurisdictions, the above provisions as they relate to each jurisdiction being, for this purpose, severable into diverse and independent covenants.

8.4 Injunctive Relief. The Employee acknowledges and agrees that, because of the unique and extraordinary nature of his services, any breach or threatened breach of the provisions of Sections 8.1, 8.2, or 8.3 hereof will cause irreparable injury and incalculable harm to the Corporation, and the Corporation shall, accordingly, be entitled to injunctive and other equitable relief for such breach or threatened breach and that resort by the Corporation to such injunctive or other equitable relief shall not be deemed to waive or to limit in any respect any right or remedy which the Corporation may have with respect to such breach or threatened breach.

8.5 Expenses of Enforcement of Covenants. In the event that any action, suit or proceeding at law or in equity is brought to enforce the covenants contained in Section 8.1, 8.2, or 8.3 hereof or to obtain money damages for the breach thereof, the party prevailing in any such action, suit or other proceeding shall be entitled upon demand to reimbursement from the other party for all expenses (including, without limitation, reasonable attorneys' fees and disbursements) incurred in connection therewith.

8.6 Non-Solicitation. The Employee covenants and agrees not to (and not to cause or direct any Person to) hire or solicit for employment any employee of the Corporation or any of its subsidiaries or affiliates. The prohibitions of this Section 8.6 shall apply (i) for six (6) months following the termination of the Employee's employment by the Corporation without Cause or by the Employee for Good Reason, prior to a Change of Control, (ii) for twelve (12) months following the termination of the Employee's employment for Cause, prior to a Change of Control, or (iii) for twenty-four (24) months following a Change of Control.

9. Indemnification. The Corporation will defend, indemnify and hold harmless the Employee, to the maximum extent permitted by applicable law and the by-laws of the Corporation, against all claims, costs, charges and expenses incurred or sustained by him in connection with any action, suit or other proceeding to which he may be made a party by reason of his being an officer, director or employee of the Corporation or of any subsidiary or affiliate thereof. Furthermore, the Corporation hereby represents that it will maintain during the Term, Directors and Officers insurance coverage in the amount of at least Five Million Dollars ($5,000,000).

10. Warranties.

The Employee hereby warrants that as of the date hereof the Employee is not employed (other than by the Corporation) and is not a party to any other employment contract, express or implied. The Employee warrants that he has no other obligation, contractual or otherwise, which would prevent him from accepting the Corporation's offer of employment under the terms of this Agreement and from complying with its provisions. The Employee warrants that he will not utilize during his employment hereunder any confidential information obtained through or in connection with his prior employment. The Employee warrants that he knows of no reason why he would not be able to perform his obligations under this Agreement. The Employee warrants that he has duly executed and delivered this Agreement and it is valid, binding and enforceable against the Employee in accordance with its terms.

The Corporation warrants to the Employee that this Agreement has been duly approved and authorized by its Board of Directors, that this Agreement has been duly executed and delivered on behalf of the Corporation and that this Agreement is valid, binding and enforceable against the Corporation in accordance with its terms.

11. Notices.

All notices, requests, consents and other communications required or permitted to be given hereunder, shall be in writing and shall be deemed to have been duly given if delivered personally or sent by facsimile, with confirmation of receipt, or mailed first-class, postage prepaid, by registered or certified mail (notices sent by mail shall be deemed to have been given three (3) business days after the date sent), to the parties at their respective addresses herein above set forth or to such other address as either party shall designate by notice in writing to the other in accordance herewith.

12. General.

12.1 Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the local laws of the State of New York applicable to agreements made and to be performed entirely in New York.

12.2 Captions. The section headings contained herein are for reference purposes only and shall not in any way affect the meaning or interpretation of this Agreement.

12.3 Entire Agreement. This Agreement sets forth the entire agreement and understanding of the parties relating to the subject matter hereof, and supersedes all prior agreements, arrangements and understandings, written or oral, relating to the subject matter hereof. No representation, promise or inducement has been made by either party that is not embodied in this Agreement, and neither party shall be bound by or liable for any alleged representation, promise or inducement not so set forth.

12.4 Assignability. This Agreement, and the Employee's rights and obligations hereunder, may not be assigned by the Employee. The Corporation may assign its rights, together with its obligations, hereunder in connection with any sale, transfer or other disposition of all or substantially all of its business or assets; in any event the rights and obligations of the Corporation hereunder shall be binding on its successors or assigns, whether by merger, consolidation or acquisition of all or substantially all of its business or assets.

12.5 Amendment. This Agreement may be amended, modified, superseded, canceled, renewed or extended and the terms or covenants hereof may be waived, only by a written instrument executed by both of the parties hereto, or in the case of a waiver, by the party waiving compliance. No superseding instrument, amendment, modification, cancellation, renewal or extension hereof shall require the consent or approval of any person other than the parties hereto. The failure of either party at any time or times to require performance of any provision hereof shall in no manner affect the right at a later time to enforce the same. No waiver by either party of the breach of any term or covenant contained in this Agreement, whether by conduct or otherwise, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such breach, or a waiver of the breach of any other term or covenant contained in this Agreement.

12.6 Counterparts. This Agreement may be executed in one or more facsimile or original counterparts, each of which shall be deemed an original, but all of which taken together will constitute one and the same instrument.

12.7 Severability. The provisions of this Agreement shall be deemed severable, and if any part of any provision is held illegal, void or invalid under applicable law, such provision may be changed to the extent reasonably necessary to make the provision, as so changed, legal, valid and binding. If any provision of this Agreement is held illegal, void or invalid in its entirety, the remaining provisions of this Agreement shall not in any way be affected or impaired but shall remain binding in accordance with their terms.

[SIGNATURE PAGE TO FOLLOW]

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

ATTEST:	HALSEY DRUG CO., INC.
___________________________	By: /s/ Andrew D. Reddick
	Andrew D. Reddick President and Chief Executive Officer
WITNESS:	EMPLOYEE
_____________________________	By: /s/ Ron J. Spivey
	Ron J. Spivey

EXHIBIT 10.4

AMENDMENT TO EXECUTIVE EMPLOYMENT AGREEMENT

THIS AMENDMENT TO EXECUTIVE EMPLOYMENT AGREEMENT (this "AMENDMENT") made this 27th day of May, 2004 by and between HALSEY DRUG CO., INC., a New York corporation (the "CORPORATION"), with offices at 616 N. North Court, Suite 120, Palatine, Illinois 60067 and ANDREW D. REDDICK, residing at 297 North Cote Circle, Exton, Pennsylvania 19341 (the "EMPLOYEE").

R E C I T A L S

A. The Corporation and the Employee executed an employment agreement dated as of August 26, 2003 (the " EMPLOYMENT AGREEMENT").

B. Pursuant to Section 5(b) of the Employment Agreement, the Corporation committed to issue to the Employee a stock option exercisable for up to 5,500,000 shares of the Corporation's common stock, $.01 par value per share (the "ORIGINAL OPTION COMMITMENT").

C. The Corporation and the Employee now desire to amend the Employment Agreement as provided herein.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, the parties agree as follows:

1. Section 5(b) of the Employment Agreement is hereby deleted in its entirety and the following is inserted in its place:

"(b) Stock Options. The Company hereby agrees to issue and deliver a stock option grant to the Employee to purchase 8,750,000 shares of the Corporation's common stock, $.01 par value per share (the "OPTION") at an exercise price of $0.13 per share. The shares subject to the Option shall vest and be exercisable as follows: (i) 2,750,000 Option shares on June 30, 2004; and (ii) the balance at the rate of 250,000 Option shares on the last day of each calendar month (the first monthly vesting period to be satisfied on July 31, 2004) until fully vested. The Option shall have a ten (10) year term, subject to earlier termination as set forth in Section 7, upon the termination of the Employee's employment with the Corporation and shall be evidenced by the Non-Qualified Stock Option Agreement in the form of Exhibit A hereto. The Employee and the Corporation agree that the Option will be issued pursuant to the Corporation's 1998 Stock Option Plan, as amended as described below, and the Option shares shall be promptly and duly registered under a registration statement on Form S-8 filed with the Securities and Exchange Commission. The Employee will also be eligible in the future to receive annual option or stock grants based on performance or on achievement of milestones as determined by the Board of Directors or the Compensation Committee.

Notwithstanding the foregoing and anything to the contrary contained in this Amendment, the Employee hereby agrees that the grant of the Option and the issuance of the Option shares are contingent upon approval by the shareholders of the Corporation at the next meeting of shareholders of amendments to the Corporation's 1998 Stock Option Plan (i) to increase the number of shares available for grants of options and stock under the 1998 Stock Option Plan, (ii) to permit the grant of non-qualified stock options (including the Option) having an exercise price per share less than the fair market value of the common stock of the Corporation on the date of issuance, and (iii) to provide for a limit of 8,750,000 option awards that may be granted to one individual in any calendar year. The Corporation hereby agrees to recommend such matter to the shareholders and to use its commercially reasonable best efforts to hold such meeting as soon as reasonably practicable, but in any event by October 31, 2004. Following receipt of such shareholder approval, the Corporation shall promptly (i) confirm in writing that the contingency described in this paragraph has been satisfied and the Option is effective, (ii) issue a replacement Option Agreement, omitting Section 6 thereof relating to such contingency, and (iii) confirm in writing that the Option shares have been duly registered in accordance with this Section 5(b)."

2. The Corporation and the Employee agree that effective as of the date of this Amendment, the Original Option Commitment shall terminate and be of no further legal force or effect.

3. Section 6 of the Employment Agreement is hereby deleted in its entirety and the following is inserted in its place:

"6. Vacation. The Employee shall be entitled to four (4) weeks of vacation during each year of the Term, to be taken at a time or times mutually agreed upon by the Employee and the Corporation. The Employee may carry over to the following year any unused vacation from the immediately preceding year; provided, however, that not more than four (4) weeks of such vacation time may be carried over to the year immediately following the year in which such vacation was to be taken, unless otherwise required by applicable law. Without limiting the foregoing, the Corporation agrees that Employee may carry over all of his unused 2003 vacation time into 2004."

4. Section 7.5(vi) of the Employment Agreement is hereby deleted in its entirety and the following is inserted in its place:

"(vi) the failure of the shareholders of the Corporation, by October 31, 2004, to approve those amendments to the Corporation's 1998 Stock Option Plan described in Section 5(b) above or, after such approval, the failure by the Corporation to comply with the other provisions of Section 5(b);"

5. Notwithstanding anything to the contrary contained in the Employment Agreement or the Option, the Employee agrees that the Corporation's sale of substantially all of its assets used in the operation of its former Congers, New York facilities does not constitute a "Change of Control" as such term is defined in the Employment Agreement.

6. The Corporation shall reimburse the Employee for the reasonable legal fees and expenses incurred by the Employee for review and negotiation of this Amendment on or before thirty (30) days following the date of execution of this Amendment.

7. Except as expressly amended by this Amendment, the Employment Agreement remains in full force and effect. Capitalized terms used herein shall have the same meaning as in the Employment Agreement unless otherwise defined herein. This Amendment shall be governed and construed and enforced in accordance with the local laws of the State of New York applicable to agreements made and to be performed entirely in New York.

8. This Amendment may be executed in one or more facsimile or original counterparts, each of which shall be deemed an original, but all of which taken together will constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this Amendment as of the date first above written.

ATTEST: HALSEY DRUG CO., INC.

____

By: /s/ Peter A. Clemens

Peter A. Clemens,
Senior Vice President and
Chief Financial Officer

WITNESS: EMPLOYEE

By: /s/ Andrew D. Reddick

Andrew D. Reddick

____

EXHIBIT 10.5

SEPARATION AGREEMENT AND GENERAL RELEASE

THIS SEPARATION AGREEMENT AND GENERAL RELEASE ("Agreement") is between MICHAEL K. REICHER ("EMPLOYEE") and HALSEY DRUG CO., INC., a corporation ("EMPLOYER").

SECTION A: PARTIES' UNDERSTANDINGS

EMPLOYEE has been employed by EMPLOYER in the capacity of Chief Executive Officer and Chairman; and

EMPLOYEE and EMPLOYER have engaged in discussions resulting in EMPLOYEE's termination from employment with EMPLOYER; and

EMPLOYEE and EMPLOYER wish to resolve any and all issues arising from EMPLOYEE's employment and/or separation from employment with EMPLOYER.

SECTION B: PARTIES' AGREEMENTS

In consideration of the above and the promises set forth in this Agreement, the parties agree as follows:

1. EMPLOYMENT TERMINATION. EMPLOYER and EMPLOYEE acknowledge that EMPLOYEE's employment as Chief Executive Officer and Chairman has been terminated by Employer without cause effective as of June 16, 2003 (the "Termination Date").

2. RESIGNATION FROM BOARD. Simultaneous with the execution of this Agreement by EMPLOYEE and EMPLOYER (the "Effective Date"), EMPLOYEE shall execute and deliver to EMPLOYER his resignation from the Board of the Directors of EMPLOYER and all subsidiaries and affiliates thereof, which Resignation shall be in the form of Exhibit A attached hereto.

3. CONSIDERATION. EMPLOYER, in recognition of and in consideration for EMPLOYEE's release of claims (as set forth in paragraph 9 of this Agreement) and covenant not to sue (as set forth in subparagraph 14 of this Agreement), agrees to provide the following to EMPLOYEE:

    a. TERMINATION PAYMENT: In full satisfaction of Paragraph 8.6 of the Employment Agreement executed by and between EMPLOYER and EMPLOYEE as of March 10, 1998, as amended by the First Amendment to Employment Agreement executed by and between the parties as of May 24, 2000 ("Employment Agreement"), EMPLOYER shall pay to EMPLOYEE the sum of Four Hundred Thousand Dollars and 00/100 Dollars ($400,000.00) (the "Severance Payment"). The Severance Payment shall be payable in equal quarterly payments of Fifty Thousand and 00/100 Dollars ($50,000), plus interest at six percent (6%) per annum, commencing October 16, 2003 and quarterly thereafter. Interest shall accrue on the Severance Payment from July 16, 2003. EMPLOYER agrees that EMPLOYEE may assign to a third party the Severance Payment and shall acknowledge and honor any such assignment, provided EMPLOYER is provided prior written notice of any such assignment. The obligation shall be evidenced by a promissory note in the form of Exhibit B hereto.

In addition, EMPLOYER shall issue to EMPLOYEE warrants to purchase one hundred fifty thousand (150,000) shares of common stock of the EMPLOYER at 34 cents ($0.34) per share. The warrant will be in the form of Exhibit C hereto.

b. INSURANCE BENEFITS/PERQUISITES:

i. For the period commencing on the Termination Date and for the next 24 months, EMPLOYER shall continue EMPLOYEE's medical insurance coverage at its full and complete expense. EMPLOYEE shall thereafter be allowed to continue his health insurance benefits at his full and complete expense to the extent allowed by the involved benefit plan and/or applicable federal law (i.e. COBRA).

ii. EMPLOYER shall remain obligated to pay all other benefits due EMPLOYEE under the terms of his Employment Agreement with EMPLOYER, including the automobile reimbursement provided for in Paragraph 5(i) of the Employment Agreement, for a period of 24 months after the Termination Date.

c. OPTIONS:

EXISTING STOCK OPTIONS: The parties agree that Exhibit D hereto describes all stock option agreements and rights to acquire shares of EMPLOYER's capital stock granted by EMPLOYER to EMPLOYEE in existence as of the date hereof. EMPLOYER and EMPLOYEE agree that all of the Stock Option Agreements shall remain in full force and effect and be exercisable in accordance with their respective terms, including as provided for in the Employment Agreement, and that this Agreement shall not modify or otherwise extend the term or time period provided for exercise of the Stock Option Agreements.

d. VACATION: EMPLOYER agrees to pay EMPLOYEE on September 16, 2003 $7,692.30 in a lump sum representing the salary equivalent of 10 vacation days, which represents all accrued vacation earned and unused by him during calendar year 2003.

e. UNEMPLOYMENT COMPENSATION: EMPLOYER agrees that it shall not contest on the basis of a "voluntary quit" EMPLOYEE's application for unemployment insurance benefits.

EMPLOYEE agrees that he has received payment from EMPLOYER of all wages, vacation and other benefits to which he was entitled by virtue of his past employment. EMPLOYEE also agrees that the benefits to be provided as set forth in sub-paragraphs (a), (b), (c) and (d) above are benefits of value to which he, as an employee or former employee of EMPLOYER, would not ordinarily be entitled.

4. TERMINATION OF EMPLOYER OBLIGATIONS UNDER EMPLOYMENT AGREEMENT AND OTHER AGREEMENTS. EMPLOYEE acknowledges and agrees that except for (i) EMPLOYER's obligations under this Agreement, and (ii) EMPLOYERS obligations the EMPLOYEE under those outstanding 5% Convertible Senior Secured Debentures due March 31, 2006 as of the date hereof (collectively, the "Debentures"), EMPLOYER has no further obligations under any agreements with EMPLOYEE, whether oral or in writing, including, without limitation, the Employment Agreement, the Stock Option Agreements or any other agreement, arrangement or understanding. The termination of EMPLOYER's obligations under the Employment Agreement shall not terminate, modify, impair or otherwise alter EMPLOYEE's obligations under Section 9 of the Employment Agreement which shall survive the execution of this Agreement as provided therein and in Section 13 of this Agreement.

5. STATEMENTS. EMPLOYEE and EMPLOYER agree that following the Effective Date neither party shall, directly or indirectly, either verbally or in writing, make any disparaging statements to third parties (including, but not limited to, persons, corporations or any other person or entity) , whether or not intended to damage the integrity or reputation of EMPLOYEE or EMPLOYER, its subsidiaries or affiliates or any of their respective officers, directors, shareholders, debentureholders, employees, representatives, agents, successors and assigns.

6. FUTURE EMPLOYMENT. It is acknowledged by the parties that EMPLOYER shall be under no obligation to reinstate or reemploy EMPLOYEE and EMPLOYEE agrees that he shall not apply for, request or otherwise seek reemployment with EMPLOYER.

7. ATTORNEY CONSULTATION. EMPLOYEE acknowledges that (i) he has had ample time and opportunity to review and analyze all the terms and provisions of this Agreement, including the Exhibits hereto, (ii) he fully understands the import of all of the terms and provisions of this Agreement, (iii) he is not relying upon any statements or representations (whether expressed or implied) of the EMPLOYER's agents or attorneys, and will not raise or seek to raise any defense against the enforcement of this Agreement based on any such statements or representations, (iv) he has not been fraudulently induced to enter into this Agreement, and (v) he has been advised of his right to be represented by counsel in the negotiation of this Agreement. EMPLOYER agrees that it will reimburse EMPLOYEE for attorneys' fees not to exceed $6,000 incurred by EMPLOYEE in connection with this Agreement.

8. OPPORTUNITY TO REVIEW AND RESCIND. EMPLOYEE and EMPLOYER acknowledge that this Agreement was presented to EMPLOYEE for review and consideration and for purposes of consulting with an attorney and that EMPLOYEE was allowed a period of not fewer than twenty-one (21) days from the date of presentation of this document to consider its terms. EMPLOYEE's decision not to sign this Agreement shall result in this document having no force or effect and in such case EMPLOYEE shall not be entitled to any of the rights or benefits hereof.

In the event that EMPLOYEE signs this Agreement, EMPLOYEE shall have seven (7) days from the date of signing in which to revoke this Agreement and this Agreement shall not become effective or enforceable until the expiration of that seven (7) day period. In the event that EMPLOYEE wishes to revoke this Agreement during that seven (7) day period, EMPLOYEE agrees that he shall provide written notice of revocation by United States Mail, postage prepaid, addressed to the following:

Halsey Drug Co., Inc.
c/o Chairman of the Board
695 North Perryville Road
Rockford, IL 61107

In order to be effective, such notice must be mailed to EMPLOYER's designated representative on or before the final day of the seven (7) day revocation period.

9. RELEASE OF CLAIMS. EMPLOYEE understands and agrees that he would not receive some of the benefits specified in Section 3 of this Agreement, except for EMPLOYEE's execution of this Agreement and that the fulfillment of promises contained herein and the benefits provided in Section 3 hereof are in full settlement and satisfaction for the full release and discharge of all actions, claims, grievances, complaints, administrative claims and demands whatsoever that EMPLOYEE had or now has against the EMPLOYER, its subsidiaries and affiliates and all of their respective agents, directors, employees, officers, shareholders, debentureholders, attorneys, partners, contractors, consultants, successors and assigns (collectively, the "Releasees") and EMPLOYEE does hereby release, acquit, satisfy and forever discharge the EMPLOYER and all Releasees and their successors and assigns from all manner of actions, causes of actions, suits, debts, sums of money, agreements, damages, judgments, and claims and demands whatsoever, known and unknown, absolute or contingent, in law or equity, that EMPLOYEE ever had or now has, against EMPLOYER, the Releasees and their successors and assigns, including, but not limited to, any claims under the Employment Agreement and the Stock Option Agreements, and any claims of unused vacation time, severance pay, wrongful discharge, or claims of discrimination on the basis of age, race, sex, color, national origin, handicap or disability, religion, ancestry, marital status and status upon discharge from the military service. Included within the provisions of this Agreement, and without limitation, EMPLOYEE acknowledges and waives any and all claims against the

EMPLOYER and Releasees under the following laws, as amended to the date hereof:

a. Rehabilitation Act of 1973;

b. Employee Retirement Income Security Act;

c. Civil Rights Act of 1964, including Title VII thereof;

d. Americans with Disabilities Act;

e. 42 United States Code, Sections 1981, 1983 and/or 1985;

f. Illinois Wage Payment and Collection Act;

g. Illinois Personnel Record Review Act;

h. Older Workers' Benefit Protection Act;

i. Civil Rights Act of 1991;

j. Consolidated Omnibus Budget Reconciliation Act of 1985, as amended;

k. Illinois Minimum Wage Law;

l. Fair Labor Standards Act;

m. Family and Medical Leave Act of 1993;

n. Illinois Workers' Compensation Act;

o. Age Discrimination in Employment Act;

p. Illinois Human Rights Act;

q. New York Law on Human Rights; and

r. New York City Law on Human Rights.

EMPLOYEE also waives and releases the Released Parties from all claims based upon statutes or laws other than those listed above, from any and all claims based upon contract or tort theories (including, but not limited to, claims of breach of contract, wrongful and/or retaliatory discharge, defamation, misrepresentation and/or intentional or negligent infliction of emotional distress) and from any and all claims of whatever type or origin, whether known or unknown, arising from or in connection with EMPLOYEE's employment or separation from employment with EMPLOYER up through and including the Effective Date.

If this Agreement is signed by EMPLOYEE, the release and waiver set forth above is made on his own behalf and on behalf of his heirs, administrators, successors, agents and legal representatives.

10. EMPLOYEE REPRESENTATIONS. EMPLOYEE further represents, acknowledges and agrees that: (i) this Agreement supercedes any and all other agreements, and any other matter either oral or in writing between EMPLOYER and EMPLOYEE; (ii) all discussion, negotiations, proposals, correspondence and/or agreements by and between the parties have not been revealed by EMPLOYEE to any third-party other than counsel; and (iii) no suit, action, claims or agency proceedings of any kind has been filed by EMPLOYEE or his agent or designated representative concerning or arising out of EMPLOYEE's employment with the EMPLOYER, the Employment Agreement, the Stock Option Agreements or otherwise relating to the subject matter of this Agreement, and that EMPLOYEE will not do so at any time hereinafter based upon the dealings with EMPLOYER and EMPLOYEE up to the date of this Agreement.

11. CONFIDENTIAL TERMS. EMPLOYEE and EMPLOYER acknowledge that they will keep confidential the terms of this Agreement and the disposition of this matter (except in connection with financial or tax reporting, seeking legal advice, pursuant to legal process or legal action to enforce the terms of this Agreement or as otherwise required by law) and will not disclose to or discuss with any third party or publicize the terms of this Agreement other than to state that the matter has been resolved to the mutual satisfaction of the parties; provided, however, that notwithstanding the foregoing, EMPLOYER may disclose the terms of this Agreement to the extent necessary to comply with its reporting obligations under United States Securities Laws and the regulations promulgated thereunder and the rules and regulations of any exchange or over-the-counter market on which EMPLOYER's shares may be listed or admitted for trading. Provided further, however, that any prohibited disclosure, discussion or publication of the terms of this Agreement will not affect the validity of the release and covenant not to sue established through this Agreement.

12. NO ADMISSION. EMPLOYEE and EMPLOYER agree that this Agreement and any obligations under this document do not constitute an admission by EMPLOYEE, EMPLOYER or any Releasee of any violation of any federal, State or local statute, law, rule or regulation, or of any liability under contract and/or tort theories.

13. SURVIVAL OF EMPLOYEE'S OBLIGATIONS UNDER SECTION 9 OF THE EMPLOYMENT AGREEMENT.

    A. Notwithstanding anything to the contrary contained in this Agreement, except as otherwise provided in Paragraph B of this Section 13, EMPLOYEE's obligations under Section 9 of the Employment Agreement shall survive and continue to be binding on EMPLOYEE in accordance with the terms thereof, including Section 9.1, Secrecy, Section 9.2, Return of Memoranda, Section 9.4, Injunctive Relief, 9.5, Expenses of Enforcement of Covenants, and Section 9.6, Non-Solicitation.

B. Notwithstanding the provisions of Section 9.3 of the Employment Agreement, the parties hereby agree that EMPLOYEE shall not at any time prior to April 30, 2005 own, manage, operate, be a director or an officer, or a consultant to any business, firm, corporation, partnership, limited liability company or other entity which is conducting any business in the pharmaceutical industry and which operates a Competing Business in the United States. For purposes of this Section 13, a "Competing Business" shall mean a business which at the Effective Date or at any time though April 30, 2005, is engaged (i) in the API production of opiate based products or (ii) in the research, development and/or commercialization of any pharmaceutical product involving any anti-abuse platform developed or in development while EMPLOYEE was employed by EMPLOYER. Notwithstanding the term of the restrictions provided in this Section 13, EMPLOYEE acknowledges and confirms his secrecy obligations under Section 9.1 of the Employment Agreement, which secrecy obligations will continue to survive the execution of this Agreement in accordance with subparagraph A above.

If any provisions of this Section 13, or any part thereof, it is held to be unenforceable because of the duration of such provision, the area covered thereby or the type of conduct restricted therein, the parties agreed that the court making such determination shall have the power to modify the duration, geographic area and/or other terms of such provisions, and as so modified, said provision shall then be enforceable. In the event that the courts of any one or more jurisdictions shall hold such provisions wholly or partially unenforceable by reason of the scope thereof or otherwise, it is the intention of the parties hereto that such determination not bar or in any way affect EMPLOYER's right to relief provided for herein in the court of any other jurisdictions as to breaches or threatened breaches of such provisions in such other jurisdictions, the above provisions as they relate to each jurisdiction being, for this purposes, severable into diverse and independent covenants.

14. COVENANT NOT TO SUE.

A. EMPLOYEE on the one part and EMPLOYER and Releasees on the other part, agree not to sue, institute or cause to be instituted any lawsuit or claim in any federal, State or local court or agency against each other arising from or attributable in any way or manner to EMPLOYEE's employment or separation from employment with EMPLOYER except with respect to the enforcement of this Agreement or any Debentures executed by EMPLOYER in favor of EMPLOYEE. This Agreement may be pleaded as a complete bar to the enforcement of any claim which EMPLOYEE on the one part and EMPLOYER and Releasees on the other part may have against each other. If any party violates the release or covenant contained herein, the prevailing party shall be entitled to collect from him reasonable attorneys' fees in connection with the enforcement of this Agreement.

B. If any provision of this Agreement or the application thereof is found to be invalid or unenforceable, such invalidity or unenforceability shall not affect any other provision of this Agreement which can be given effect without the invalid or unenforceable provision. In the event that the release provisions of this Agreement are found by a Court and/or agency of competent jurisdiction to be invalid or unenforceable, EMPLOYEE agrees that he shall return to EMPLOYER all of the Severance Payment and the Severance Option and the value of the other benefits provided him pursuant to the provisions of paragraph 3 above.

C. Neither this Agreement nor any term hereof may be orally changed, waived, discharged or terminated. On the contrary, this Agreement may only be changed, waived, discharged or terminated by means of a written agreement signed by each of the parties.

15. DEBENTURES UNAFFECTED. Notwithstanding any provision herein to the contrary, any and all Debentures in existence as of the Effective Date, executed by EMPLOYER in favor of EMPLOYEE, shall remain in full force and effect following the Effective Date.

16. RETURN OF EMPLOYER PROPERTY. Simultaneous with the execution of this Agreement, EMPLOYEE shall return all confidential information and EMPLOYER's property in his possession to the EMPLOYER, including any EMPLOYER credit cards (if applicable). EMPLOYER agrees that EMPLOYEE may retain his laptop computer and that all other property of EMPLOYER has previously been returned by EMPLOYEE.

17. GOVERNING LAW. Except as provided in the promissory note attached hereto as Exhibit B, the terms of this Agreement shall be interpreted under the laws of the State of New York. Each of the parties hereto hereby irrevocably and unconditionally submits, to the non-exclusive jurisdiction of any New York State court or United States Federal court sitting in New York City, and any appellant court from any thereof, in any action or proceeding arising out of or relating to this Agreement, or for recognition or enforcement of any judgment, and each of the parties hereto unconditionally agrees that all claims in respect of any such action or proceeding may be heard and determined in any such New York State court or, to the fullest extent permitted by law, in such United States Federal court. Each of the parties hereto agree that a final judgment in any such action or proceeding shall be conclusive and may be enforced in any other jurisdictions by suit on the right that any party may otherwise have to bring any action or proceeding relating to this Agreement in the courts of any other jurisdiction. Each of the parties hereto further and unconditionally waive, to the fullest extent as it

may legally and effectively do so, any objection that it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or in relation to this Agreement in any such New York State or United State Federal court sitting in New York City. Each of the parties hereto hereby waives, to the fullest extent permitted by law, the defense of any inconvenient forum to the maintenance of such action or proceeding in any such court.

18. INTERPRETATION. This AGREEMENT is a result of negotiations between the parties, none of whom have acted under any duress or compulsion, whether legal, economic or otherwise. Accordingly, the parties hereby waive the application of any rule or law that otherwise would be applicable in connection with the construction of this AGREEMENT that ambiguous or conflicting terms or provisions should be construed against the party who (or whose attorney) prepared the executed AGREEMENT or any earlier draft of the same. The section titles and other headings contained in this Agreement are for reference only and shall not affect in any way the meaning or interpretation of this Agreement.

19. PLAIN LANGUAGE. EMPLOYEE and EMPLOYER acknowledge that each of them has read this Agreement, that each of them fully understands the meaning of the Agreement, that the Agreement is written in a manner calculated to be understood by EMPLOYEE, that they have had the opportunity to confer with their attorneys regarding the terms and meanings of the Agreement, that no representation has been made to either of them by the other party except as set forth herein, and that each of them KNOWINGLY and VOLUNTARILY enters into this Agreement and agrees to comply with its terms.

20. COUNTERPARTS. This Agreement may be executed in one or more counterparts, each of which shall be an original, but all of which taken together shall constitute one and the same instrument.

/s/ Michael K. Reicher

MICHAEL K. REICHER

I, MICHAEL K. REICHER, knowingly and voluntarily enter into and agree to the terms of the above "Separation Agreement and General Release" this 18th day of September, 2003. I acknowledge that before signing this Agreement I was given a twenty-one (21) day period in which to consider this document and I was informed of my right to consult with an attorney. I further acknowledge that I have been informed of my right to revoke this Agreement within seven (7) days of my signing of this Agreement.

/s/ Michael K. Reicher

MICHAEL K. REICHER

SUBSCRIBED AND SWORN BEFORE
ME ON THIS 18th DAY OF SEPTEMBER
SEPTEMBER, 2003.

____

NOTARY PUBLIC

HALSEY DRUG CO., INC.,
a New York corporation

By: /s/ Peter Clemens

Name: Peter Clemens
Title: Vice President and Chief Financial Officer
Date: September 18, 2003

EXHIBIT 10.6

FIRST AMENDMENT TO SEPARATION AGREEMENT AND GENERAL RELEASE

THIS FIRST AMENDMENT (the "AMENDMENT") TO SEPARATION AGREEMENT AND GENERAL RELEASE by and between Halsey Drug Co., Inc. (the "CORPORATION") and Michael K. Reicher ("REICHER"), dated September 18, 2003 (the "SEPARATION AGREEMENT"), is dated December 4, 2003.

RECITALS

A. The Company and Reicher entered into the Separation Agreement providing the terms of Reicher's termination of employment with the Company.

B. Under the terms of the Separation Agreement, the Company agreed, inter alia, (i) to make a termination payment to Reicher in the amount of $400,000 in the form of a note bearing interest at 6% per annum and maturing on July 16, 2006 (the "Note"), (ii) to pay Reicher $7,260.30 representing his earned and unused vacation for the calendar year 2003, (iii) to reimburse Reicher for attorneys' fees incurred by Reicher in connection with the Separation Agreement, not to exceed $6,000, and (iv) to continue Reicher's health insurance coverage and certain other benefits for the period of twenty four (24) months commencing on June 16, 2003.

C. On or about November 6, 2003, Reicher filed a Complaint in Illinois Circuit Court of the 17th Judicial Circuit (the "Court") seeking to enforce the Separation Agreement The ("Complaint").

D. The Company is in default of the Note by failing to make the first installment due under the Note on October 16, 2003 and the Company has represented to Reicher that it will not have the ability to fulfill its obligations under the Note or the Separation Agreement and has requested Reicher to renegotiate and forgive a portion of the indebtedness and obligations.

E. The Company has represented to Reicher that the negotiations and debt forgiveness is necessary for the Company to reorganize so it can continue operations and access new capital.

F. The parties desire to enter into this Amendment, inter alia, to settle in full the Company's payment obligations to Reicher under the Separation Agreement.

NOW, THEREFORE, in consideration of the foregoing premises and the mutual covenants and obligations set forth herein, the Company and Reicher hereby agree as follows:

1. Reicher agrees to compromise the monetary payments due him under the terms of the Separation Agreement. Reicher agrees to accept, and the Company agrees to pay to Reicher, the amount of $162,789.64 as and for full satisfaction of the Company's obligations as set forth in Paragraph B of the Recitals as well as any other monetary obligations of the Company under the Separation Agreement,

except for medical coverage as set forth in Paragraph 2 below. The payment shall be payable on the date of execution of this Amendment.

2. Section 3(b) of the Separation Agreement is hereby deleted in its entirety and replaced with the following:

> "For the period commencing on the Termination Date and ending on March 31, 2004, EMPLOYER shall continue EMPLOYEE's medical insurance coverage at its full and complete expense."

3. The Promissory Note, dated September 18, 2003, in the principal amount of $400,000, issued by the Company in favor of Reicher pursuant to Section 3(a) of the Separation Agreement is, upon receipt of the payment required by Paragraph 1 hereof, fully satisfied. Reicher agrees to return such Promissory Note to the Company upon receipt of the payment. Reicher further waives and releases the Company from any and all interest and fees which may have accrued under the said Promissory Note including, without limitation, in connection with any default by the Company thereunder.

4. In the event that (i) a petition is filed by or against the Company, with any court of competent jurisdiction, seeking reorganization or liquidation of the Company under the United States Bankruptcy Code, as amended (the "CODE"), (ii) such court determines that the payment to Reicher set forth in Paragraph 1 of this Amendment is deemed a "preference" under the Code, and (iii) Reicher is required to pay and pays to the Bankruptcy Trustee the amount of such payment, the amendments set forth in Paragraphs 1 through 3 of this Amendment shall be deemed null and void and Reicher's claim for the amounts provided in the Separation Agreement, without giving effect to this Amendment, shall be deemed reinstated in full.

5. Reicher hereby consents to, and agrees to execute such documents as shall be necessary to effect, any and all amendments to, waivers of and releases from any and all restrictions set forth in, the Debenture and Warrant Purchase Agreement dated March 10, 1998, by and among the Company and certain signatories thereto and any and all documents executed in connection therewith, including, without limitation, the 5% Convertible Senior Secured Debentures issued thereunder (the "Debentures"), each as amended through the date hereof, which consents, waivers and releases may be required so as to (a) facilitate the purchase by certain investors of the promissory notes issued by the Company to Watson Pharmaceuticals, Inc., including the succession by such investors to the priority liens securing the Company's obligations under such promissory notes, and (b) allow the Company to obtain working capital financing to fund operations through 2004. Such consents, waivers and releases shall include, without limitation (i) waivers of lien, indebtedness, registration rights, transfer and other contractual restrictions, (ii) release and/or subordination of liens on Company and subsidiary assets, and (iii) conversion of the Debentures into equity of the Company; provided, however, that in each case (x) the holders of a majority in the

principal amount of the Debentures shall provide the same consents, waivers and releases as is requested of Reicher, and (y) each of the holders of the Debentures, in their capacity as Debenture holders, shall be treated, in all material respects, substantially identical.

6. Reicher shall execute and file with the Court within ten (10) days of the date hereof an appropriate order or stipulation voluntarily dismissing the Complaint with prejudice, and shall provide a filed copy to Halsey. Such dismissal shall not affect Reicher's right under this Amendment.

7. The Company hereby represents that it is currently engaged in negotiations with other unsecured creditors seeking to obtain payment reductions of the Company's outstanding obligations due to such creditors. As part of such negotiations the Company is seeking payment concessions which are consistent in all material respects in magnitude with the revised payment terms set forth in this Amendment.

8. The Company and Reicher agree that, except as expressly modified herein, all provisions of the Separation Agreement shall remain in full force and effect.

9. This Amendment may be executed in two or more facsimile counterparts, each of which shall be deemed an original but all of which shall constitute the same Amendment.

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed by their respective duly authorized officers as of the date first above written.

HALSEY DRUG CO., INC.

By: /s/ Andrew D. Reddick

Name: Andrew D. Reddick
Title: President and Chief Executive Officer

/s/ Michael K. Reicher

MICHAEL K. REICHER

EXHIBIT 10.7

ASSET PURCHASE AGREEMENT

This Asset Purchase Agreement ("Agreement") is made and entered into as of this 18th day of February, 2004, by and among Mutual Pharmaceutical Company, Inc., a Pennsylvania corporation, having its principal offices located at 1100 Orthodox Street, Philadelphia, Pennsylvania 19124 (hereinafter referred to as the "Purchaser"), and Halsey Drug Co., Inc., a New York corporation having its principal offices located at 16235 State Road 17, Culver, Indiana 46511 (hereinafter referred to as the "Seller").

RECITALS

WHEREAS, Seller is engaged in the development of proprietary prescription pharmaceutical products and is the owner of certain abbreviated new drug applications ("ANDAs") set forth on Exhibit A attached hereto; and

WHEREAS, Seller desires to convey, sell and assign certain Assets (as defined herein) to Purchaser upon the terms and subject to the conditions set forth in this Agreement; and

WHEREAS, Purchaser desires to purchase the Assets and obtain the requisite regulatory marketing authorization to resume marketing of some or all of the products referenced in the Purchased ANDAs (as hereinafter defined), upon the terms and subject to the conditions set forth in this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the premises and mutual promises contained herein, the parties hereto agree as follows:

SECTION 1

ACQUISITION OF ASSETS

1.01 Assets to be Conveyed. On the terms and subject to the conditions contained herein, on the Closing Date (as that term is defined in Section 3.01 hereof) Seller shall convey, transfer, assign, sell and deliver to Purchaser, and Purchaser shall acquire, accept and purchase, all right, title and interest in and to those certain ANDAs set forth on Exhibit A attached hereto (the "Purchased ANDAs"), including, without limitation, all of the properties and rights of the Seller relating to the Purchased ANDAs as described in (a) and (b) below (hereinafter, collectively with the "Purchased ANDA Assets"):

(a) all documentation, files, binders, technical data and information that is owned by and in the possession of Seller whether stored in hard copy or electronically, including, without limitation all specifications, formulae, stability data, manufacturing processes, master batch records, quality control data, analytical methods, and other information of any kind including annual reports, bioequivalence and bioavailability test results relating to the Purchased ANDAs and,

(b) Any and all approvals, authorizations, licenses and consents of the U.S. Food and Drug Administration (the "FDA"), any governmental agency or entity, or any third party, relating to the Purchased ANDAs.

1.02 Status of Purchased ANDAs. Notwithstanding anything to the contrary contained herein, Purchaser understands and acknowledges that the Purchased ANDAs have been withdrawn from the Orange book, or are discontinued or are otherwise not active ANDAs and will require manufacturing site transfer and/or other technical revisions or improvements in accordance with applicable regulations in order to regain marketing authorization from the FDA.

1.03 Further Assurances. From time to time after the Closing, the parties shall execute and deliver such instruments of sale, transfer, conveyance, assignment and delivery, consents, assurances, and other instruments and do all matters and things which may be necessary in order to convey to Purchaser title to the Purchased ANDA Assets and to carry out the purpose and intent of this Agreement.

SECTION 2

CONSIDERATION TO BE PAID BY PURCHASER

2.01 Purchase Price and Delivery of Assets. In full consideration of the sale of the Purchased ANDA Assets, Purchaser shall remit to Seller two million dollars (US$2,000,000) in immediately available funds by wire transfer to an account designated by Seller. Upon wire transfer of such amount, Seller shall assist Purchaser in packing and loading the Purchased ANDA Assets into Purchaser's vehicle for shipment to a location to be determined by the Purchaser.

SECTION 3

CLOSING DATE

3.01 Closing Date; Bill of Sale. The closing of the sale and purchase of the Purchased ANDA Assets shall take place by facsimile or at the offices of St. John & Wayne, L.L.C., Two Penn Plaza East, Newark, New Jersey 07105 (the "Closing") on or before February 18, 2004 (the "Closing Date") or such other date mutually agreed to by Seller and Purchaser. On the Closing Date, Seller shall deliver to Purchaser a Bill of Sale conveying to Purchaser Seller's right, title and interest in and to the Purchased ANDA Assets in substantially the form of Exhibit 3.01 (attached hereto) together with such fully-executed correspondence from Seller to the FDA as may be required to (a) inform the FDA of the purchase and sale of the Purchased ANDAs, and (b) establish the Purchaser as the new regulatory agent for such Purchased ANDAs from and after the Closing Date. Seller's form letter to the FDA is attached as Exhibit B hereto.

SECTION 4

REPRESENTATIONS AND WARRANTIES OF SELLER

Seller hereby represents and warrants to Purchaser as follows:

4.01 Organization of Seller. (a) Seller is a corporation organized and validly existing and in good standing under the laws of the State of New York and Seller has the full power and authority to convey the Purchased ANDA Assets herein sold by Seller; (b) the execution and delivery of this Agreement and the performance by Seller of its obligations hereunder have been duly authorized by all necessary corporate action; and (c) this Agreement is a valid and binding obligation of Seller enforceable against it in accordance with its terms, except as enforceability of this Agreement may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting creditors' rights generally.

4.02 Execution of Documents. Neither the execution and delivery of this Agreement nor the performance by Seller of any of its obligations hereunder, nor the consummation of any of the transactions contemplated hereby will (a) violate or conflict with any agreement to which Seller is a party or by which Seller or any of its assets may be bound; (b) violate or conflict with any provision of the Seller's Certificate of Incorporation, By-Laws, or other organizational documents; or (c) be prevented, limited by or be in conflict with or result in a breach of or default under any material indenture, agreement or other instrument to which Seller is a party or by which Seller is bound.

4.03 Third Party Rights. Seller has not sold, transferred, sublicensed, pledged, encumbered or granted any rights or interest in the Purchased ANDAs to any third party, and prior to the Closing, Seller shall not enter into any such agreement with any third party. Except as otherwise disclosed in Schedule 4.3 hereto, there are no oral or written agreements, commitments or understandings with third parties pertaining to the manufacture, production, packaging, labeling, marketing, distribution or sale of any of the products described in the Purchased ANDAs.

4.04 Purchased ANDA Products. To the best of Seller's knowledge, there is no product available for purchase in the marketplace that was manufactured pursuant to the Purchased ANDAs and that is within the expiration date for such product.

4.05 Limitation of Warranties. EXCEPT AS SET FORTH ABOVE, SELLER MAKES NO WARRANTIES, EXPRESS OR IMPLIED, WITH RESPECT TO THE PURCHASED ANDAs OR THE PURCHASED ANDA ASSETS AND ALL SUCH PURCHASED ANDA ASSETS ARE PURCHASED "AS IS". ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING, WITHOUT LIMITATION, THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, ARE HEREBY DISCLAIMED BY SELLER.

SECTION 5

REPRESENTATIONS AND WARRANTIES OF PURCHASER

The Purchaser represents and warrants to Seller as follows:

5.01 Corporate Organization of the Purchaser. Purchaser is a corporation organized, validly existing and in good standing under the laws of the State of Pennsylvania. The execution and delivery of this Agreement and the performance by Purchaser of its obligations hereunder have been duly authorized by all necessary corporate action on the part of Purchaser. This Agreement is a valid and binding obligation of Purchaser enforceable against Purchaser in accordance with its terms, except as enforceability of this Agreement may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or other similar laws affecting creditors' rights generally.

5.02 Execution of Documents. Neither the execution and delivery of this Agreement nor the performance by Purchaser of any of its obligations hereunder, nor the consummation of any of the transactions contemplated hereby will (a) violate or conflict with any agreement to which Purchaser is a party or by which Purchaser or any of its property may be bound; (b) violate or conflict with any provision of Purchaser's Certificate of Incorporation or By-laws or other organizational documents; or (c) be prevented, limited by or be in conflict with or result in a breach of or default under any material indenture, agreement or other instrument to which Purchaser is a party or by which Purchaser or its property is bound.

SECTION 6

COVENANTS OF PURCHASER

6.01 Trademarks and Trade Dress. Purchaser shall not promote, sell or distribute any of the products (if any) developed pursuant to the Purchased ANDAs under trademarks, tradenames, service marks or names which are identical or confusingly similar to any trademarks, tradenames, service marks or names used by Seller in connection with the sale of any of its products; provided, however, that it is expressly acknowledged and understood that nothing in this Section 6.01 shall be construed to require Purchaser to change the size, shape or color of the products described in the Purchased ANDAs prior to the marketing and sale of such products.

SECTION 7

INDEMNITY

7.01 Indemnification by Seller. Seller shall indemnify and hold Purchaser, its affiliates, directors, officers, employees, agents, attorneys and the successors and/or assigns of any of the foregoing (the "Purchaser Indemnitees") from and against any and all liabilities, damages, losses, costs or expenses (including attorneys' fees, professional fees and other expenses of litigation and/or arbitration) resulting from the marketing or sale of any products covered by any of the Purchased ANDAs by Seller, its affiliates or any designated third party prior to the Closing Date. Notwithstanding the foregoing or anything to the contrary contained herein, in no event shall Seller's aggregate indemnity obligation to Purchaser Indemnitees under this Agreement exceed two million dollars (US$2,000,000).

7.02 Indemnification by Purchaser. Purchaser shall indemnify and hold Seller, its subsidiaries, directors, officers, employees, agents, attorneys and the successors and/or assigns of any of the foregoing (the "Seller Indemnitees") harmless from and against any and all liabilities, damages, losses, costs and expenses (including reasonable attorney and professional fees and other expenses of litigation and/or arbitration) resulting from the manufacture and sale of any products developed pursuant to or otherwise covered by any of the Purchased ANDAs by Purchaser, its affiliates or any designated third party subsequent to the Closing Date.

7.03 Indemnification Notice. A party (the "Indemnitee") that intends to claim indemnification under this Section 7 shall promptly notify the other party (the "Indemnitor") in writing of any loss, claim, damage, liability or action in respect of which the Indemnitee or any of its subsidiaries, directors, officers, employees or agents intend to claim such indemnification, and the Indemnitor shall have the right to participate in and, to the extent the Indemnitor so desires, to assume the defense thereof with counsel mutually satisfactory to the parties. The indemnity provided herein shall not apply to amounts paid in settlement of any loss, claim, damage, liability or action if such settlement is effected without the consent of the Indemnitor, which consent shall not be unreasonably withheld or delayed. Failure to deliver written notice to the Indemnitor within a reasonable time after the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve the Indemnitor of any liability to the Indemnitee under this Section 7. At the Indemnitor's request, the Indemnitee under this Section 7, and its employees and agents, shall fully cooperate with the Indemnitor and its legal representatives in the investigation of any action, claim or liability covered by this indemnification and provide full information with respect thereto.

7.04 NOTWITHSTANDING ANYTHING TO CONTRARY CONTAINED HEREIN, NEITHER PARTY SHALL UNDER ANY CIRCUMSTANCES BE LIABLE FOR ANY CLAIMS FOR ANY INCIDENTAL, CONSEQUENTIAL, INDIRECT OR SPECIAL DAMAGES, INCLUDING ANY LOST PROFITS OR SAVINGS, ARISING FROM ANY BREACH OF WARRANTY OR THE PERFORMANCE OR BREACH OF ANY PROVISION OF THIS AGREEMENT OR THE USE OF ANY PURCHASED ANDA ASSET, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

SECTION 8

SURVIVAL OF REPRESENTATIONS, WARRANTIES AND COVENANTS

8.01 Survival of Representations, Warranties and Covenants. All the representations, warranties, covenants and agreements of Seller and Purchaser contained herein (including all Schedules and Exhibits hereto) including the indemnity obligations under Section 7 hereof shall survive without limitation.

SECTION 9

EXPENSES

9.01 Fees and Expenses. Except as otherwise provided herein, Purchaser and Seller will each be solely responsible for their respective expenses, including, without limitation, fees and expenses of legal counsel, accountants, and other advisors incurred in connection with the consummation of the transactions contemplated hereby. No broker's or finder's fee or commission will be payable with respect to this Agreement or any of the transactions contemplated hereby or thereby, and Purchaser and Seller hereby indemnify each other against, and agree that they will hold each other harmless from, any claim, demand or liability for any such broker's or finder's fees alleged to have been incurred in connection herewith or therewith and any expenses (including reasonable fees, expenses and disbursements of counsel) arising in connection with any such claim, demand or liability.

SECTION 10

DISPUTE RESOLUTION

10.01 Arbitration. Should the parties to this Agreement fail to resolve any controversy or claim arising out of or relating to the interpretation or application of any term or provision set forth herein, or the alleged breach hereof, such controversy or claim shall be resolved by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. Judgement upon any award rendered pursuant to the terms set forth herein may be entered in any court having jurisdiction over the party against whom the award is rendered. Any award rendered pursuant to the terms and conditions set forth herein shall be final and binding upon the parties and their subsidiaries. Any arbitration held pursuant to this Agreement shall be held in Newark, New Jersey or such other site as the parties may mutually agree. In no event shall the arbitrators in any arbitration proceeding relating to this Agreement be authorized to award punitive damages under any circumstances. All costs and expenses, including reasonable attorney's fees incurred in the enforcement of this Agreement shall be satisfied by the party incurring such expenses.

SECTION 11

MISCELLANEOUS PROVISIONS

11.01 Amendment and Modification. The parties hereto may amend, modify and supplement this Agreement in such manner as may be agreed upon by them in a writing executed by each of the parties.

11.02 Notices. All notices, requests, demands and other communications hereunder shall be deemed to have been duly given if delivered by hand on the date of such delivery or if mailed, certified or registered mail, return receipt requested, with postage prepaid, three days after the date of posting or, if sent via telecopier, upon receipt of reasonably adequate confirmation thereof:

(a) if to the Seller at:

Halsey Drug Co., Inc.
16235 State Road 17
Culver, Indiana 46511
Attention: Andrew D. Reddick
President and Chief Executive Officer
Telephone No.: (610) 304-6106
Facsimile No.: (610) 280-3221

Copy to: St. John & Wayne, L.L.C.
Two Penn Plaza East
Newark, New Jersey 07105
Attention: John P. Reilly, Esq.
Telephone No.: (973) 491-3600
Facsimile No.: (973) 491-3555

(b) if to the Purchaser at:

Mutual Pharmaceutical Company, Inc.
1100 Orathodox Street
Philadelphia, Pennsylvania 19124
Attention: President
Telephone No.: (215) 288-6500
Facsimile No.: (215) 744-1929

Copy to: Quinn, Emanuel, Urquhart & Hedges, LLP
335 Madison Avenue
New York, New York 10017
Telephone No.: (212) 702-8107
Facsimile No.: (212) 702-8700

11.03 Headings. The headings of the sections of this Agreement are for convenience only and shall not constitute a part hereof.

11.04 Public Announcements. Except to the extent disclosure may be required by applicable law or the rules or regulations of any stock exchange or over-the-counter market on which such party's stock is traded, neither party shall issue or make any public announcement or press release, or otherwise make any public statement, with respect to this Agreement without obtaining the other party's approval, which approval shall not be unreasonably withheld or delayed.

11.05 Entire Agreement. This Agreement and other documents specifically referred to herein which form a part hereof or are marked for identification by each of the parties hereto, contain the entire understanding of the parties hereto in respect of the subject matter contained herein. There are no restrictions, promises, warranties, covenants or undertakings, other than those expressly set forth herein.

11.06 Force Majeure. No party shall be liable to the other party for delay or failure in the performance of the obligations on its part contained in this Agreement if and to the extent that such failure or delay is due to circumstances beyond its control which it could not have avoided by the exercise of reasonable diligence. The affected party shall notify the other party promptly should such circumstances arise, giving an indication of the likely extent and duration thereof, and shall use all commercially reasonable efforts to resume performance of its obligations as soon as practicable.

11.07 Assignment.

A. Assignment to Affiliates. A party may assign any of its rights or obligations under this Agreement to any of its Affiliates, for so long as they remain Affiliates; provided, however, that such assignment shall not relieve the assigning party of its responsibilities for performance of its obligations under this Agreement.

B. Binding Nature of Assignment. This Agreement shall be binding upon and inure to the benefit of the successors and permitted assigns of the parties.

11.08 No Waiver. The failure of either party to require performance by the other party of any of the other party's obligations hereunder shall in no manner affect the right of such party to enforce the same at a later time. No waiver by either party hereto of any condition, or of the breach of any provision, term, representation or warranty contained in this Agreement, whether by conduct or otherwise, in any one or more instances, shall be deemed to be or construed as a further or continuing waiver of any such condition or breach, or of any other condition or of the breach of any other provision, term, representation or warranty hereof.

11.09 Severability. If a court or other tribunal of competent jurisdiction should hold any term or provisions of this Agreement to be excessive, or invalid, void or unenforceable, the offending term or provision shall be deleted or revised to the extent necessary to be enforceable, and, if possible, replaced by a term or provision which, so far as practicable achieves the legitimate aims of the parties.

11.10 Relationship between the Parties. Seller and Purchaser are independent contractors under this Agreement. Nothing herein contained shall be deemed to create an employment, agency, joint venture or partnership relationship between the parties hereto or any of their agents or employees, or any other legal arrangement that would impose liability upon one party for the act or failure to act of the other party. No party shall have on accord of this Agreement any express or implied power to enter into any contracts or commitments or to incur any liabilities in the name of, or on behalf of, the other party, or to bind the other party in any respect whatsoever.

11.11 Facsimile Execution. This document may be executed in facsimile counterpart each of which is hereby agreed to have the legal binding effect of an original signature. The parties hereto agree to forward original signatures by overnight mail upon execution.

11.12 GOVERNING LAW. IT IS THE INTENTION OF THE PARTIES HERETO THAT THIS AGREEMENT AND THE RIGHTS, OBLIGATIONS AND REMEDIES OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK. WHENEVER POSSIBLE EACH PROVISION OF THIS AGREEMENT SHALL BE INTERPRETED IN SUCH MANNER, AS TO BE EFFECTIVE AND VALID UNDER NEW YORK LAW, BUT IF ANY PROVISION OF THIS AGREEMENT SHALL BE PROHIBITED BY OR INVALID UNDER SUCH APPLICABLE LAW, SAID PROVISION SHALL BE INEFFECTIVE TO THE EXTENT OF THE PROHIBITION OR INVALIDITY, WITHOUT INVALIDATING THE REMAINDER OF THE PROVISION OR THE REMAINING PROVISIONS OF THIS AGREEMENT.

IN WITNESS WHEREOF, the parties have duly executed and delivered this Asset Purchase Agreement as of the 18th day of February, 2004.

Attest:	HALSEY DRUG CO., INC.
	By: /s/ Andrew D. Reddick
By:______________________________	--------------------------------
Name:	Andrew D. Reddick
Title:	President and Chief Executive Officer
Attest:	MUTUAL PHARMACEUTICAL COMPANY, INC.
	By: /s/Richard H . Roberts
By:______________________________	--------------------------------
Name:	Richard H. Roberts, M.D., Ph.D.
Title:	President and Chief Executive Officer

EXHIBIT 10.8

AMENDMENT TO DEBENTURE AND SHARE PURCHASE AGREEMENT

This AMENDMENT (the "AMENDMENT") to DEBENTURE AND SHARE PURCHASE AGREEMENT, dated as of February 6, 2004 (the "2004 DEBENTURE PURCHASE AGREEMENT"), by and among Halsey Drug Co., Inc. (the "COMPANY"), Galen Partners III, L.P. ("GALEN"), Care Capital Investments II, LP ("CARE"), Essex Woodlands Health Ventures V, L.P. ("ESSEX", and collectively with Galen and Care, the "MAJORITY LENDERS"), and other signatories thereto (including, without limitation, through Joinder Agreements) (collectively with the Majority Lenders, the "LENDERS"), is dated this 1st day of June, 2004. Capitalized terms used herein which are not defined herein have the meanings ascribed to them in the 2004 Debenture Purchase Agreement.

WHEREAS, pursuant to the terms of the 2004 Debenture Purchase Agreement, the aggregate principal amount of the Debentures cannot exceed $14 million without the prior written consent of the holders of at least 60% of the principal amount of the Debentures then held by the Majority Lenders;

WHEREAS, pursuant to the terms of the 2004 Debenture Purchase Agreement, no Debenture may be issued after the Termination Date;

WHEREAS, as of the date of this Amendment, the Company has issued Debentures in the aggregate principal amount of $14,000,000.00 under the 2004 Debenture Purchase Agreement;

WHEREAS, the Company proposes to issue additional Debentures, such that the aggregate principal amount of Debentures to be issued under the 2004 Debenture Purchase Agreement will exceed $14,000,000;

WHEREAS, the Company anticipates that some Debentures may be issued after the Termination Date;

WHEREAS, pursuant to Section 14.1 of the 2004 Debenture Purchase Agreement, an amendment of any provision of the 2004 Debenture Purchase Agreement must be in writing and signed by the Company (and the Company's Independent Committee) and the holders of at least 60% of the principal amount of the Debentures then held by the Lenders;

WHEREAS, the Majority Lenders are holders of at least 60% of the principal amount of Debentures presently held by the Lenders;

WHEREAS, the Majority Lenders desire to amend the 2004 Debenture Purchase Agreement as set forth below;

NOW, THEREFORE, in consideration of the foregoing premises and the mutual covenants and obligations set forth herein, the parties hereby agree as follows:

1. Section 3.1 of the 2004 Debenture Purchase Agreement is hereby deleted in its entirety and replaced with the following:

   "The initial Closing will take place at the offices of St. John & Wayne, L.L.C., Two Penn Plaza East, Newark, New Jersey 07105 simultaneously with the execution of this Agreement, or such other place, time and date as shall be mutually agreed to by the Company and the Purchasers. The Company and the Purchasers acknowledge and agree that the Debentures may be sold by the Company on one or more Closing Dates; provided, however, that (i) the aggregate principal amount of the Debentures shall not exceed $17,500,000 without the prior written consent of the holders of at least 60% of the principal amount of the Debentures then held by Capital Investment II, LP, Essex Woodlands Health Ventures V, L.P., Galen Partners III, L.P. and (ii) that no Debentures shall be issued after the Termination Date. Upon the issuance of additional Debentures under this Agreement, any additional Purchaser (each an "Additional Investor") shall be required to execute a Joinder Agreement, which Joinder Agreement shall include the aggregate principal amount of the Debentures issued to such Purchaser. Any Additional Investors in the Debentures executing a Joinder Agreement shall be deemed a "Purchaser" for all purposes of this Agreement. Each issuance to an Additional Investor shall be made on the terms and conditions of this Agreement."

2. The Definition of "Termination Date" set forth in Article XX of the 2004 Debenture Purchase Agreement is hereby deleted in its entirety and replaced with the following:

   "Termination Date" means the earlier of (a) June 30, 2004, or (b) the Conversion Event.

3. The parties hereto agree that, except as expressly modified by this Amendment, all provisions of the 2004 Debenture Purchase Agreement shall remain in full force and effect.

4. This Amendment may be executed in any number of counterparts, including by facsimile copy, each of which shall be deemed an original, but all of which together shall constitute one instrument.

IN WITNESS WHEREOF, the parties hereto, intending to be legally bound, have executed this Amendment on the date written above.

HALSEY DRUG CO., INC.
616 N. North Court, Suite 120
Palatine, IL 60067

/s/ Andrew D. Reddick
- --
By: Andrew D. Reddick
Its: President and Chief Executive Officer

/s/ William Sumner
- --
By: William Sumner
Its: Independent Committee Member

/s/ William Skelly
- --
By: William Skelly
Its: Independent Committee Member

/s/ Alan Smith
- --
By: Alan Smith
Its: Independent Committee Member

GALEN PARTNERS III, L.P.
By: Claudius, L.L.C., General Partner
610 Fifth Avenue, 5th Fl.
New York, New York 10019

/s/ Srini Conjeevaram
- --
By: Srini Conjeevaram
Its: General Partner

CARE CAPITAL INVESTMENTS II, LP
By: Care Capital, L.L.C., General Partner
Princeton Overlook One
100 Overlook Center, Suite 102
Princeton, New Jersey 08540

/s/ David R. Ramsay
- --
By: David R. Ramsay
Its: Authorized Signatory

ESSEX WOODLANDS HEALTH VENTURES V, L.P.
By: Essex Woodlands Health Ventures V, L.L.C.,
its General Partner
190 South LaSalle Street, Suite 2800
Chicago, IL 60603

/s/ Immanuel Thangaraj
- --
By: Immanuel Thangaraj
Its: Managing Director

EXHIBIT 10.9

FIRST AMENDMENT TO DEBENTURE PURCHASE AGREEMENT

This FIRST AMENDMENT TO DEBENTURE PURCHASE AGREEMENT (the "AMENDMENT") dated December 20, 2002, by and among Halsey Drug Co., Inc. (the "COMPANY"), Galen Partners III, L.P. ("GALEN"), Care Capital Investments II, LP ("CARE"), Essex Woodlands Health Ventures V, L.P. ("ESSEX") and other signatories thereto (the "PURCHASE AGREEMENT") is made this 11th day of August, 2003. Capitalized terms not defined herein shall have the meanings ascribed to them in the Purchase Agreement.

RECITALS

A. On December 20, 2002, the Company issued approximately $26,400,000 in principal amount of 5% Convertible Senior Secured Debentures due March 31, 2006 (the "2002 DEBENTURES"), all in accordance with the Purchase Agreement;

B. Section 1.2(b) of the Purchase Agreements allows the Company to issue additional 2002 Debentures, provided, however, that (i) the aggregate principal amount of the 2002 Debentures does not exceed $35 million and (ii) no 2002 Debentures (other than debentures evidencing the payment of interest on the 2002 Debentures) are to be issued after August 30, 2003 (the "TERMINATION DATE")

C. On May 5, 2003, at the Company's request, the Company received a letter executed by each of Galen, Care and Essex (the "MAJORITY 2002 DEBENTUREHOLDERS") advising that the Majority 2002 Debentureholders would provide funding to meet the Company's 2003 capital requirements, up to an aggregate amount not to exceed $8.6 million (the "LETTER OF SUPPORT").

D. It is contemplated that the funding by the Majority 2002 Debentureholders under the Letter of Support will continue after the Termination Date

E. The parties desire to amend the Purchase Agreement to provide for a new Termination Date.

NOW, THEREFORE, in consideration of the foregoing premises and the mutual covenants and obligations set forth herein, the parties hereby agree as follows:

1. The Purchase Agreement, including, without limitation, Section 1.2(b) and Article XX thereof, is hereby amended to change the definition of Termination Date to mean December 31, 2003.

2. The parties hereto agree that, expect as expressly modified herein, all provisions of the Purchase Agreement shall remain in full force and effect.

3. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original but all of which shall constitute the same Amendment.

IN WITNESS WHEREOF, the parties have cause this Amendment to be executed by their respective duly authorized officers a of the date first above written.

HALSEY DRUG CO., INC.

By: /s/ Peter A. Clemens

Peter A. Clemens
Acting Chief Executive Officer

GALEN PARTNERS III, L.P.
By: Claudius, L.L.C., General Partner
610 Fifth Avenue, 5th Fl.
New York, New York 10019

/s/ Srini Conjeevaram
- ---------------------------------------
By: Srini Conjeevaram
Its: General Partner

GALEN EMPLOYEE FUND III, L.P.
By: Wesson Enterprises, Inc.
610 Fifth Avenue, 5th Floor
New York, New York 10020

/s/ Bruce F. Wesson
- ---------------------------------------
By: Bruce F. Wesson
Its: General Partner

CARE CAPITAL INVESTMENTS II, LP
By: Care Capital II, LLC, General Partner
Princeton Overlook One
100 Overlook Center, Suite 102
Princeton, New Jersey 08540

/s/ David R. Ramsay
- ---------------------------------------
By: David R. Ramsay
Its: Authorized Signatory

GALEN PARTNERS INTERNATIONAL, III, L.P.
By: Claudius, L.L.C., General Partner
610 Fifth Avenue, 5th Floor
New York, New York 10020

/s/ Srini Conjeevaram
- ---------------------------------------
By: Srini Conjeevaram
Its: General Partner

ESSEX WOODLANDS HEALTH VENTURES V, L.P.
By: Essex Woodlands Health Ventures V, L.L.C.,
its General Partner
190 South LaSalle Street, Suite 2800
Chicago, IL 60603

/s/ Immanuel Thangaraj
- ---------------------------------------
By: Immanuel Thangaraj
Its: Managing Director

EXHIBIT 10.10

May 5, 2003

Mr. Peter Clemens
Chief Financial Officer
Halsey Drug Company
695 North Perryville Road
Rockford, IL 61107

Dear Peter:

We are aware that Halsey Drug Company is in the process of seeking to attract significant funding from outside investors to meet its near term capital requirements. Care Capital LLC, Essex Woodlands Health Ventures and Galen Partners III, L.P. (the "Investors") encourages this effort and, in order to help facilitate this process and provide additional support to the financial stability of the Company, the Investors are willing to provide a level of financial assistance as may be required to help the Company meet working capital needs through the remainder of the 2003 fiscal year ending December 31, 2003. This willingness is based on the Investors' assumption that Halsey's projected needs will not exceed a total of $8.6 million during such period, assuming no other funding is raised.

If the Company completes an equity financing of $8.6 million or more prior to the end of 2003, this commitment will expire at that time. If less then $8.6 million is raised in the financing and if a portion of the shortfall is nevertheless required for the Company to meet its near term capital requirements, the Investors will be committed to provide such shortfall, limited to $2 million from Galen Partners III, L.P., $4.6 million from Essex Woodlands Health Ventures, and $2 million from Care Capital LLC, on terms mutually acceptable to Halsey and the Investor group.

Sincerely,

Galen Partners III, L.P.	Care Capital LLC	Essex Woodlands Health Ventures Fund V, L.P.
/s/ Bruce F. Wesson	/s/ David R. Ramsay	/s/ Immanuel Thangaraj
Bruce F. Wesson	David R. Ramsay	Immanuel Thangaraj
General Partner	Partner	Managing Director

EXHIBIT 31.1

CERTIFICATION OF PERIODIC REPORT PURSUANT TO RULES 13a-14 AND 15d-14 OF THE SECURITIES EXCHANGE ACT OF 1934

I, Andrew D. Reddick, the Chief Executive Officer of Halsey Drug Co., Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Halsey Drug Co., Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 6, 2004

/s/ Andrew D. Reddick

Andrew D. Reddick
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF PERIODIC REPORT PURSUANT TO RULES 13a-14 AND 15d-14
OF THE SECURITIES EXCHANGE ACT OF 1934

I, Peter A. Clemens, the Chief Financial Officer of Halsey Drug Co., Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Halsey Drug Co., Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   d) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   e) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   f) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 6, 2004

/s/ Peter A. Clemens

Peter A. Clemens
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION OF PERIODIC REPORT PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Halsey Drug Co., Inc. (the "Company") on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Andrew D. Reddick, the Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 6, 2004

/s/ Andrew D. Reddick

Andrew D. Reddick
Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION OF PERIODIC REPORT PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Halsey Drug Co., Inc. (the "Company") on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter A. Clemens, the Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(3) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(4) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 6, 2004

/s/ Peter A. Clemens

Peter A. Clemens
Chief Financial Officer