

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, 2001

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.)

695 N. Perryville Rd.
Rockford, IL

61107

(Address of Principal executive offices) (Zip Code)

(815) 399 - 2060

(Registrant's telephone number, including area code)

Not Applicable

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

Indicate by check 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

As of July 31, 2001 the registrant had 15,013,240 Shares of Common Stock, \$.01 par value, outstanding.

HALSEY DRUG CO., & SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)	(UNAUDITED)	
	2001	2000
	JUNE 30	DECEMBER 31
	-----	-----
CURRENT ASSETS		
Cash and cash equivalents	\$ 975	\$ 697
Accounts Receivable - trade, net of allowances for doubtful accounts of \$198 and \$315 at June 30, 2001 and December 31, 2000, respectively	414	3,487
Other receivables	8	645
Inventories	2,409	2,769
Prepaid expenses and other current assets	217	545
	-----	-----
Total current assets	4,023	8,143
PROPERTY PLANT & EQUIPMENT, NET	5,427	5,332
DEFERRED PRIVATE OFFERING COSTS	895	1,138
OTHER ASSETS AND DEPOSITS	854	596
	-----	-----
	\$11,199	\$15,209
	=====	=====

The accompanying notes are an integral part of these statements

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

(Amounts in thousands)	(UNAUDITED)	
	2001	2000
	JUNE 30	DECEMBER 31
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Notes payable	92	1,844
Accounts payable	1,864	2,671
Accrued expenses	5,311	5,889
Convertible Subordinated Debentures	2,500	2,500
Department of Justice Settlement	300	300
	-----	-----
Total current liabilities	10,067	13,204
CONVERTIBLE SENIOR SECURED DEBENTURES, NET	44,228	42,279
TERM NOTE PAYABLE	14,000	12,000
DEPARTMENT OF JUSTICE SETTLEMENT	925	1,075
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock - \$.01 par value; authorized 80,000,000 shares; issued 14,995,932 shares at June 30, 2001 and 14,961,316 shares at December 31, 2000	150	149
Additional paid-in capital	35,470	35,440
Accumulated deficit	(93,641)	(88,938)
	-----	-----
	(58,021)	(53,349)
	-----	-----
	\$ 11,199	\$ 15,209
	=====	=====

The accompanying notes are an integral part of these statements

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

Amounts in thousands except per share data

	June 30			
	For the six months ended		For the three months ended	
	2001	2000	2001	2000
	-----	-----	-----	-----
Product sales	\$ 4,928	\$ 7,217	\$ 1,962	\$ 4,066
Product development revenues	5,000	5,000	--	5,000
	-----	-----	-----	-----
Net product revenues	9,928	12,217	1,962	9,066

Cost of manufacturing	7,847	8,792	3,278	5,077
Research & development	620	670	314	277
Selling, general and administrative expenses	3,011	3,200	1,350	1,572
	-----	-----	-----	-----
Income (loss) from operations	(1,550)	(445)	(2,980)	2,140
Amortization of deferred debt discount and private offering costs	(1,161)	(1,222)	(580)	(616)
Interest expense, net	(1,965)	(1,894)	(1,019)	(993)
Other income (expense)	(22)	128	(12)	118
	-----	-----	-----	-----
Income (loss) before income taxes	(4,698)	(3,433)	(4,591)	649
	-----	-----	-----	-----
Income tax (expense) benefit	(5)	296	(5)	296
	-----	-----	-----	-----
Net income (loss)	\$ (4,703)	\$ (3,137)	\$ (4,596)	\$ 945
	=====	=====	=====	=====
Net income (loss) per share (basic and diluted)	\$ (0.31)	\$ (0.22)	\$ (0.30)	\$ 0.07
	=====	=====	=====	=====
Average number of outstanding shares	14,987,326	14,445,463	14,995,742	14,463,050
	=====	=====	=====	=====

The accompanying notes are an integral part of these statements

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HALSEY DRUG CO., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

Amounts in thousands	SIX MONTHS ENDED	
	JUNE 30	
	2001	2000
	----	----
Cash flows from operating activities		
Net loss	\$ (4,703)	\$ (3,137)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	509	348
Amortization of deferred debt discount and deferred private offering costs	1,162	1,222
Provision for losses on accounts receivable	(117)	(272)
Gain on sale of assets	--	(123)
Stock issued for trade payables	--	15
Debentures and stock issued for interest expense	1,061	981
Changes in assets and liabilities		
Accounts receivable	3,190	(1,003)
Other receivable	637	(123)
Inventories	360	52
Prepaid expenses and other current assets	328	(166)
Other assets and deposits	(250)	(555)
Accounts payable	(807)	(1,024)
Accrued expenses	(578)	71
	-----	-----
Total adjustments	5,495	(577)
	-----	-----

Net cash provided by (used in) operating activities	792	(3,714)
	-----	-----
Cash flows from investing activities		
Capital expenditures	(586)	(287)
Net proceeds from the sale of assets	--	123
Investment in joint venture	(26)	--
	-----	-----
Net cash used in investing activities	(612)	(164)
	-----	-----
Cash flows from financing activities		
Proceeds from issuance of term notes payable	2,000	9,000
Payments to Department of Justice	(150)	(175)
Payments on notes payable	(1,752)	(1,890)
	-----	-----
Net cash provided by financing activities	98	6,935
	-----	-----
NET INCREASE IN CASH AND CASH EQUIVALENTS	278	3,057
Cash and cash equivalents at beginning of period	697	786
	-----	-----
Cash and cash equivalents at end of period	\$ 975	\$ 3,843
	=====	=====

Supplemental disclosures of noncash investing and financing activities:
For the 6 months ended June 30, 2001

1. The Company issued 34,616 shares of common stock as payment for \$30,289 in debenture accrued interest.
2. The Company issued \$1,029,695 of debentures as payment for like amounts of debenture accrued interest.

The accompanying notes are an integral part of these statements

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HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

SIX MONTHS ENDED JUNE 30, 2001

AMOUNTS IN THOUSANDS EXCEPT PER SHARE DATA

(UNAUDITED)

	Common Stock, \$.01 par value		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount			
	-----	-----	-----	-----	-----
Balance January 1, 2001	14,961,316	\$ 149	\$ 35,440	\$ (88,938)	\$ (53,349)
Net Loss for the six months ended June 30, 2001				(4,703)	(4,703)
Issuance of shares as payment of interest	34,616	1	30		31
	-----	-----	-----	-----	-----
Balance at June 30, 2001	14,995,932	\$ 150	\$ 35,470	\$ (93,641)	\$ (58,021)
	=====	=====	=====	=====	=====

The accompanying notes are an integral part of this statement.

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HALSEY DRUG CO., INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL

STATEMENTS

(UNAUDITED)

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 for complete financial statements. In the opinion of management, all adjustments considered necessary to present fairly the financial position, results of operations and changes in cash flows for the six months ended June 30, 2001 have been made. The results of operations for the six months period ended June 30, 2001 are not necessarily indicative of the results that may be expected for the full year ended December 31, 2001. 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, 2000 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

As of June 30, 2001, the Company had working capital deficiency of approximately \$6,044,000 and an accumulated deficit of approximately \$93,641,000. The Company incurred a loss of approximately \$4,703,000 during the six months ended June 30, 2001.

Until such time as the Company successfully develops and commercializes new finished dosage products and active pharmaceutical ingredients, of which there can be no assurance, the Company will continue to incur operating losses and negative cash flow. The Company believes that the final payment under the Product Purchase Agreement of \$3.5 million received on July 10, 2001 combined with the \$3.5 million balance available under the Watson Term Loan will be sufficient to satisfy the Company's working capital requirements only for the next six (6) months.

The Company's efforts to obtain the approval of the U.S. Drug Enforcement Administration ("DEA") for a registration to import raw materials for use in production, including contesting any resulting third-party opposition proceeding, and the continuing development of the Company's licensed technologies will continue through 2004. In order to fund continued operations, satisfy the Galen Bridge Loan and to fund the continued development of the Company's licensed technologies, which includes the completion of planned capital improvements to the Company's Culver, Indiana and Congers, NY facilities and the processing of the registrations and approvals required from the DEA (including funding the legal fees and related expenses in connection with any opposition proceeding relating to the Company's request for a raw material import registration) during the period from fiscal 2002 through and including fiscal 2004, the Company estimates that it will be required to obtain additional sources of financing or a third party equity investment of approximately \$15.0 million. The Company is currently seeking additional funds through transactions related to its business lines as well as private financings. There can be no assurance, however, that such additional financing will be available to the Company on acceptable terms, if at all. Failure to obtain such financing or equity investment may require the Company (i) to delay or cease the continued development of its licensed technologies and the completion of planned capital expenditures, (ii) to obtain funds through arrangements with third parties on terms that may require the Company to relinquish rights to its licensed technologies which the Company would otherwise pursue on its own or that would dilute the Company's stockholders and/or (iii) to significantly scale back or

terminate operations. An extended delay or a cessation of the Company's continuing development efforts relating to its licensed technologies or delays in obtaining required DEA approvals, will have a material adverse effect on the Company's financial condition and results of operations.

Note 2 - Inventories

(Amounts in thousands)

Inventories consists of the following:

	June 30, 2001 -----	December 31, 2000 -----
Finished Goods	\$ 113	\$ 225
Work in Process	711	1,146
Raw Materials	1,585	1,398
	-----	-----
	\$ 2,409	\$ 2,769
	=====	=====

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NOTE 3 - CONVERTIBLE DEBENTURES

CONVERTIBLE DEBENTURES CONSIST OF THE FOLLOWING:

	JUNE 30, 2001 -----	DECEMBER 31, 2000 -----
Senior Secured Debentures - 5.0%	\$ 47,477	\$ 46,446
Subordinated Debentures - 10.0%	2,500	2,500
	-----	-----
Less current maturity	(2,500)	(2,500)
	-----	-----
	47,477	46,446
	-----	-----
Less unamortized debt discount	(3,249)	(4,167)
	-----	-----
	\$ 44,228	\$ 42,279
	=====	=====

NOTE 4 - NOTES PAYABLE

Notes payable consist of the following:

	JUNE 30, 2001 -----	DECEMBER 31, 2000 -----
Unsecured promissory demand notes	\$ 92	\$ 1,844
	=====	=====
Term note payable	\$ 14,000	\$ 12,000
	=====	=====

As of June 30, 2001, Watson Pharmaceuticals, Inc. had advanced \$14,000,000 to the Company under a term loan. The loan is secured by a first lien on all of the

Company's assets, senior to the lien securing all other Company indebtedness, carries a floating rate of interest equal to prime plus two percent and matures on March 31, 2003.

NOTE 5 - CONTINGENCIES

The Company currently is a defendant in several lawsuits involving product liability claims. The Company's insurance carriers have assumed the defense for all product liability and other actions involving the Company. The final outcome of these lawsuits cannot be determined at this time, and accordingly, no adjustment has been made to the consolidated financial statements.

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 \]HALSEY DRUG CO., INC. AND SUBSIDIARIES

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

	Six months ended June 30			Three months ended June 30		
	Percentage of Net Sales		Percentage Change Year-to-Year Increase (decrease)	Percentage of Net Sales		Percentage Change Year-to-Year Increase (decrease)
	2001	2000	2001 as compared to 2000	2001	2000	2001 as compared to 2000
Product sales	49.6	59.1	(31.7)	100.0	44.8	(51.7)
Product development revenues	50.4	40.9			55.2	(100.0)
Net product revenues	100.0	100.0	(18.7)	100.0	100.0	(78.4)
Cost of manufacturing	79.0	72.0	(10.7)	167.1	56.0	(35.4)
Research & development	6.2	5.5	(7.5)	16.0	3.1	13.4
Selling, general and administrative expenses	30.3	26.2	(5.9)	68.9	17.3	(14.1)
Income (loss) from operations	(15.6)	(3.6)	248.3	(151.9)	23.6	(239.3)
Amortization of deferred debt discount and private offering costs	11.7	10.0	(5.0)	29.6	6.8	(5.8)
Interest expense, net	19.8	15.5	3.7	51.9	11.0	2.6
Other income (expense)	(0.2)	1.0	(117.2)	(0.6)	1.3	(110.2)
Income (loss) before income taxes	(47.3)	(28.1)	36.8	(234.0)	7.2	(807.6)
Income tax (expense) benefit	(0.1)	2.4	(101.7)	(0.3)	3.3	(101.7)
Net income (loss)	(47.4)	(25.7)	49.9	(234.3)	10.4	(586.5)

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 SIX MONTHS ENDED JUNE 30, 2001 VS SIX MONTHS ENDED JUNE 30, 2000

NET PRODUCT REVENUES

The Company's net product revenues for the six months ended June 30, 2001 of \$9,928,000 represents a decrease of \$2,289,000 (18.7%) as compared to net product revenues for the six months ended June 30, 2000 of \$12,217,000. During both the six month periods ending June 30, 2001 and 2000, the Company recognized 5,000,000 of product development revenues associated with the sale of certain product rights to Watson Pharmaceuticals, Inc. The decrease

in product sales was due to the inability of the Company to obtain certain raw materials during the six months ended June 30, 2001. The Company believes that these raw materials will become available in the later half of the year. On an ongoing basis, the Company expects to generate revenues from the development and manufacture of both finished dosage and active pharmaceutical ingredients ("API's"), and then partnering with others for the marketing and distribution of these products.

COST OF MANUFACTURING

For the six months ended June 30, 2001, cost of manufacturing decreased \$945,000 to \$7,847,000 as compared to the six months ended June 30, 2000 of \$8,792,000. This decrease is primarily attributable to 1) reduced costs associated with decreased sales and 2) the elimination of manufacturing overhead expenses from the closure of the Company's Brooklyn, New York facility in March 2001

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses as a percentage of sales for the six months ended June 30, 2001 and 2000 were 30.3% and 26.2%, respectively. Overall these expenses in the first six months of 2001 decreased \$189,000 over the same period in 2000. The decrease is primarily attributable to the elimination of the Company's outside sales department during the second quarter of 2000.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses as a percentage of sales for the six months ended June 30, 2001 and 2000 were 6.2% and 5.5 %, respectively. The Company's research and development program is concentrating its efforts in three areas.

First, the Company is continuing development efforts relating to certain API's. The Company currently manufactures two API's and has seven others under development.

Second, the Company is proceeding with the development of products, apart from those obtained from Barr Laboratories, for submission to the FDA. The Company expects the submission of 7 ANDA supplements or amendments to the FDA during fiscal 2001 each of which relate to the site transfer of existing ANDAs from the Company's former Brooklyn, New York facility to its Congers, New York facility.

Third, the Company is performing the necessary regulatory steps to effect the transfer of the products obtained from Barr Laboratories in April, 1999 to the Company. The Company initially has identified 8 of the products for which it will devote substantial effort in seeking approval from the FDA for manufacture and sale. The Company estimates that certain of these Barr Products will be available for sale in the fourth quarter of 2001.

NET INCOME (LOSS)

For the six months ended June 30, 2001, the Company had net loss of \$4,703,000 as compared to a net loss of \$3,137,000 for the six months ended June 30, 2000. Included in the results for the six months ended June 30, 2001 was interest expense of \$1,965,000 and amortization of deferred debt discount and private offering costs of \$1,161,000 as compared to \$1,894,000 and \$1,222,000, respectively, for the year earlier period. Included in results for the six months ended June 30, 2000 was a tax benefit of \$296,000 from the settlement of a income tax refund claim originally submitted in 1996. Additionally, the Company recorded a gain on the sale of equipment of \$128,000 in 2000.

THREE MONTHS ENDED JUNE 30, 2001 VS THREE MONTHS ENDED JUNE 30, 2000

NET PRODUCT REVENUES

The Company's net product revenues for the three months ended June 30, 2001 of \$1,962,000 represents a decrease of \$7,104,000 (78.4%) as compared to net product revenues for the three months ended June 30, 2000 of \$9,066,000. This

decrease is primarily a result of the recognition of \$5,000,000 in the three month period ended June 30, 2001 versus \$5,000,000 in the three month period ended June 30, 2000 of product development revenues associated with the sale of certain product rights to Watson Pharmaceuticals, Inc. Additionally, product sales decreased because the Company was unable to obtain certain raw materials during the three months ending June 30, 2001. The Company believes that these raw materials will become available in the later part of the year. On an ongoing basis, the Company expects to generate revenues from the development and manufacture of both finished dosage and active pharmaceutical ingredients ("API's"), and then partnering with others for the marketing and distribution of these products.

COST OF MANUFACTURING

For the three months ended June 30, 2001, cost of manufacturing decreased by approximately \$1,799,000 as compared to the three months ended June 30, 2000. The decrease for 2001 is attributable to both reduced costs associated with decreased sales and the elimination of manufacturing overhead expenses from the closure of the Company's Brooklyn, New York facility in March 2001.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses as a percentage of sales for the three months ended June 30, 2001 and 2000 were 68.9% and 17.3%, respectively. The decrease of \$221,000 is due primarily to elimination of the Company's outside sales department during the second quarter of 2000.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses as a percentage of sales for the three months ended June 30, 2001 and 2000 was 16.0% and 3.1%, respectively. The Company's research and development program is concentrating its efforts in three areas.

First, the Company is continuing development efforts relating to certain API's. The Company currently manufactures two API's and has seven others under development.

Second, the Company is proceeding with the development of products, apart from those obtained from Barr Laboratories, for submission to the FDA. The Company expects the submission of 7 ANDA supplements or amendments to the FDA during fiscal 2001 each of which relate to the site transfer of existing ANDAs from the Company's former Brooklyn, New York facility to its Congers, New York facility.

Third, the Company is performing the necessary regulatory steps to effect the transfer of the products obtained from Barr Laboratories in April, 1999 to the Company. The Company initially has identified 8 of the products for which it will devote substantial effort in seeking approval from the FDA for manufacture and sale. The Company estimates that certain of these Barr Products will be available for sale in the fourth quarter of 2001.

NET INCOME (LOSS)

For the three months ended June 30, 2001, the Company had a net loss of \$4,591,000 as compared to net income of \$945,000 for the three months ended June 30, 2000. Included in the results for the three months ended June 30, 2001 was interest expense of \$1,019,000 and amortization of deferred debt discount and private offering costs of \$580,000 as compared to \$993,000 and \$616,000, respectively, for the year earlier period. Included in results for the three months ended June 30, 2000 was a tax benefit of \$296,000 from the settlement of a income tax refund claim originally submitted in 1996. Additionally, the Company recorded a gain on the sale of equipment of \$118,000 in 2000.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2001, the Company had cash and cash equivalents of \$975,000 as compared to \$697,000 at December 31, 2000. The Company had working capital deficiency at June 30, 2001 of \$6,044,000 as compared to a working capital deficiency of \$5,061,000 at December 31, 2000.

During the period from May 1997 through July 1997, the Company borrowed approximately \$3 million from Mylan Laboratories, Inc. pursuant to five unsecured, demand promissory notes. The advances made by Mylan Laboratories, Inc. were part of a proposed investment by Mylan Laboratories, Inc. in the Company, including the proposed purchase of the Company's Culver, Indiana facility as well as partial tender offer for the Company's common stock. The Company used the proceeds of these borrowings for working capital. As of July 6, 2001, the entire indebtedness and any outstanding accrued interest has been satisfied in full in the form of product deliveries to Mylan.

In addition to the other strategic alliance transactions with Watson Pharmaceuticals, Inc. ("Watson") completed on March 29, 2000, the Company and Watson executed a Loan Agreement providing for Watson's extension of a \$17,500,000 term loan to the Company (the "Watson Term Loan"). The Watson Term Loan is funded in installments upon the Company's request for advances and the provision to Watson of a supporting use of proceeds relating to each such advance. As of August 6, 2001, \$14 million had been advanced by Watson to the Company under the Watson Term Loan. The Watson Term Loan is secured by a first lien on all of the Company's assets, senior to the liens securing all other Company indebtedness, carries a floating rate of interest equal to prime plus two percent and matures on March 31, 2003. As of July 31, 2001, a portion of the net proceeds of the Watson Term Loan were used to satisfy in full bridge loans made by Galen Partners to the Company during 2000, to satisfy the Company's payment obligations under the Settlement Agreement with the landlord of its Brooklyn, New York facility, to fund capital improvements and for working capital. In addition, pursuant to the terms of the Product Purchase Agreement with Watson dated March 29, 2000 (the "Product Purchase Agreement"), on July 10, 2001 Watson remitted \$3,500,000 to the Company representing the final installment for the doxycycline monohydrate product purchased by Watson from the Company. The proceeds of this installment as well as the remaining net proceeds of the Watson Term Loan will, in large part, be used to complete the upgrades to the API manufacturing facility of Houba, Inc., the Company's wholly-owned subsidiary, to complete the upgrades to the Company's Congers, New York leased facilities, and for working capital to fund continued operations.

Pursuant to the terms of the Core Products Supply Agreement with Watson, Watson was required to purchase and pay for on a quarterly basis a minimum of \$3,060,000 for products supplied by the Company under such Agreement. For the three quarters ending December 31, 2000, Watson had made an advance payment of approximately \$4,402,000 as required under the terms of the Core Products Supply Agreement to be applied against future product purchases under such Agreement. The advance payments and any additional advance payments made by Watson under the Core Products Supply Agreement will require that the Company supply Watson with a like amount of products without additional payments from Watson at such time. On August 8, 2001, the Company and Watson executed an amendment to the Core Products Supply Agreement (the "Core Products Amendment") providing (i) for a reduction of Watson's minimum purchase requirements from \$3,060,000 to \$1,500,000 per quarter, (ii) for an extension of Watson's minimum purchase requirements from the quarter ending September 30, 2001 to quarter ending September 30, 2002, (iii) for Watson to recover previous advance payments made under the Core Products Supply Agreement in the form of the Company's provision of products having a purchase price of up to \$750,000 per quarter (such credit amount to be in excess of Watson's \$1,500,000 minimum quarterly purchase obligation), and (iv) for the Company's repayment to Watson of any remaining advance payments made by Watson under the Core Products Supply Agreement (and which amount has not been recovered by product deliveries by the Company to Watson as provided in Subsection (iii) above) in two (2) equal monthly installments on October 1, 2002 and

The Company has issued and outstanding 10% convertible subordinated debentures in the principal amount of \$2,500,000 issued in August 1996 and which matured on August 6, 2001 (the "1996 Debentures"). The Company and Galen Partners III, L.P. and certain of its Affiliates (collectively, the "Galen Group") have agreed in principle to the terms of a proposed bridge loan to be made by the Galen Group to the Company in the principal amount of \$2,500,000 to be used to retire and satisfy in full the outstanding 1996 Debentures (the "Galen Bridge Loan"). While the definitive loan documents required to complete the Galen Bridge Loan are in the process of being prepared, it is contemplated

that the Galen Bridge Loan will bear interest at the rate of 10% per annum and be secured by a lien on all the Company's assets, junior to the security interest granted to Watson under the Watson Term Loan but senior to the security interest granted to the holders of the Company's 5% convertible subordinated debentures issued in March, 1998 and May, 1999. The Galen Bridge Loan Note will be convertible into common stock at a conversion price equal to the trading average of the Company's common stock for the 20 days preceding the closing date. It is also contemplated that in consideration for the extension of the Galen Bridge Loan, the Company will issue to the Galen Group common stock purchase warrants to purchase an aggregate of 187,500 shares of the Company's common stock at an exercise price equal to the 20 day trading average of the Company's common stock for the 20 days preceding the closing of the Galen Bridge Loan. The Galen Bridge Loan warrants are contemplated to be substantially identical to those issued in the Company's Debenture and Warrant Offerings completed in March, 1998 and May, 1999. It is anticipated that the Galen Bridge Loan will have a maturity date of December 31, 2001.

Until such time as the Company successfully develops and commercializes new finished dosage products and active pharmaceutical ingredients, of which there can be no assurance, the Company will continue to incur operating losses and negative cash flow. The Company believes that the final payment under the Product Purchase Agreement of \$3.5 million received on July 10, 2001 combined with the \$3.5 million balance available under the Watson Term Loan will be sufficient to satisfy the Company's working capital requirements only for the next six (6) months.

The Company's efforts to obtain the approval of the U.S. Drug Enforcement Administration ("DEA") for a registration to import raw materials for use in production, including contesting any resulting third-party opposition proceeding, and the continuing development of the Company's licensed technologies will continue through 2004. In order to fund continued operations, satisfy the Galen Bridge Loan and to fund the continued development of the Company's licensed technologies, which includes the completion of planned capital improvements to the Company's Culver, Indiana and Congers, NY facilities and the processing of the registrations and approvals required from the DEA (including funding the legal fees and related expenses in connection with any opposition proceeding relating to the Company's request for a raw material import registration) during the period from fiscal 2002 through and including fiscal 2004, the Company estimates that it will be required to obtain additional sources of financing or a third party equity investment of approximately \$15.0 million. The Company is currently seeking additional funds through transactions related to its business lines as well as private financings. There can be no assurance, however, that such additional financing will be available to the Company on acceptable terms, if at all. Failure to obtain such financing or equity investment may require the Company (i) to delay or cease the continued development of its licensed technologies and the completion of planned capital expenditures, (ii) to obtain funds through arrangements with third parties on terms that may require the Company to relinquish rights to its licensed technologies which the Company would otherwise pursue on its own or that would dilute the Company's stockholders and/or (iii) to significantly scale back or terminate operations. An extended delay or a cessation of the Company's continuing development efforts relating to its licensed technologies or delays in obtaining required DEA approvals, will have a material adverse effect on the Company's financial condition and results of operations.

PART II OTHER INFORMATION
ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the quarter ended June 30, 2001, the Company issued an aggregate of 17,308 shares of Common Stock and 5% Convertible Debenture in the principal amount of \$518,031 in satisfaction of accrued interest on the Company's outstanding Convertible Debentures issued in March and June 1998, and May and July 1999 (the "Convertible Debentures").

Each of the holders of the Convertible Debentures for which interest payments were made in Common Stock and 5% Convertible Senior Secured Debentures are accredited investors as defined in Rule 501(a) of Regulation D promulgated under the Securities Act of 1933, as amended (the "Act"). The Common Stock and 5% Convertible Senior Secured Debentures issued in satisfaction of the interest

payments under 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company's 2001 Annual Meeting of Shareholders was held on Thursday, June 14, 2001 for the following purposes:

1. To elect ten directors to the Company's Board of Directors to hold office until the 2002 Annual Meeting of Shareholders ("Proposal 1"); and
2. To adopt an amendment to the Company's 1998 Stock Option Plan to increase the number of shares available for grant under the Plan ("Proposal 2"); and
3. To ratify the appointment of Grant Thornton LLP as independent auditors of the Company for the fiscal year ending December 31, 2001 ("Proposal 3")

The voting as to each Proposal was as follows:

PROPOSAL 1

NAME ----	FOR ---	WITHHELD -----
Michael Reicher	36,403,835	142,362
William Skelly	36,390,569	155,628
Alan Smith, Ph.D.	36,403,621	142,576
William Sumner	36,405,850	140,347
Bruce Wesson	36,405,262	140,935
Srini Conjeevaram	36,403,747	142,450
Zubeen Shroff	36,404,869	141,328
Peter Clemens	36,406,369	139,828
Joel Liffmann	36,404,818	141,379
Gerald Price	36,406,369	139,828

PROPOSAL 2

FOR ---	AGAINST -----	ABSTAIN -----
28,436,397	774,908	32,270

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PROPOSAL 3

FOR ---	AGAINST -----	ABSTAIN -----
36,554,004	44,926	14,192

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 Index.
- (b) Reports on Form 8-K. None.

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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 14, 2001

HALSEY DRUG CO., INC.

By: /s/ Michael K. Reicher

Michael K. Reicher
Chairman,
and Chief Executive Officer

By: /s/ Peter A. Clemens

Peter A. Clemens
VP & Chief Financial Officer