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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

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 (I.R.S. Employer Identification No.)
incorporation or organization)

695 N. PERRYVILLE ROAD, CRIMSON BUILDING NO. 2, UNIT 4
ROCKFORD, ILLINOIS 61107
(Address of Principal Executive Offices) (Zip Code)

(815) 399-2060
(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 No

As of August 13, 2003 the registrant had 21,224,398 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, 2003	DECEMBER 31, 2002
	-----	-----
	(IN THOUSANDS)	
CURRENT ASSETS		
Cash	\$ 50	\$ 9,211
Accounts Receivable - trade, net of allowances for doubtful accounts of \$16 and \$14 at June 30, 2003 and December 31, 2002, respectively	841	610
Inventories	2,537	2,285
Prepaid expenses and other current assets	686	394
	-----	-----
Total current assets	4,114	12,500
PROPERTY, PLANT & EQUIPMENT, NET	5,789	5,367
DEFERRED PRIVATE OFFERING COSTS, net of accumulated amortization of \$306 and \$9 at June 30, 2003 and December 31, 2002, respectively	1,317	1,032
OTHER ASSETS AND DEPOSITS	394	465
	-----	-----
	\$11,614	\$19,364
	=====	=====

The accompanying notes are an integral part of these statements.

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

	(UNAUDITED) JUNE 30, 2003 -----	DECEMBER 31, 2002 -----
	(IN THOUSANDS, EXCEPT SHARE DATA)	
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Current maturities of notes payable and capital lease obligations	\$ 52	\$ 33
Accounts payable	2,517	3,119
Accrued expenses	3,632	3,115
Department of Justice Settlement	300	300
	-----	-----
Total current liabilities	6,501	6,567
TERM NOTE PAYABLE	21,401	21,401
CONVERTIBLE SUBORDINATED DEBENTURES	79,042	77,118
Less: debt discount	(62,578)	(73,955)
	-----	-----
.....	16,464	3,163
CAPITAL LEASE OBLIGATIONS	111	40
DEPARTMENT OF JUSTICE SETTLEMENT	299	461
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Common stock - \$.01 par value; authorized 80,000,000 shares; issued and outstanding, 21,095,092 shares and 21,035,323 at June 30, 2003 and December 31, 2002, respectively	211	211
Additional paid-in capital	149,319	148,611
Accumulated deficit	(182,692)	(161,090)
	-----	-----
	(33,162)	(12,268)
	-----	-----
	\$ 11,614	\$ 19,364
	=====	=====

The accompanying notes are an integral part of these statements.

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

(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	FOR THE SIX MONTHS ENDED		FOR THE THREE MONTHS ENDED	
	2003	2002	2003	2002
Net product revenues	\$ 2,732	\$ 4,139	\$ 1,206	\$ 2,258
Cost of manufacturing	5,138	6,254	2,265	3,353
Research and development	616	757	287	385
Selling, general and administrative expenses	3,917	3,515	2,206	1,899
Plant shutdown costs	--	(120)	--	--
Loss from operations	(6,939)	(6,267)	(3,552)	(3,379)
Other income (expense)				
Interest expense	(2,904)	(2,173)	(1,471)	(1,135)
Interest income	21	7	4	3
Amortization of deferred debt discount and private offering costs	(11,683)	(4,375)	(5,916)	(2,840)
Other	(97)	(11)	(92)	11
NET LOSS	\$ (21,602)	\$ (12,819)	\$ (11,027)	\$ (7,340)
Basic and diluted loss per share	\$ (1.03)	\$ (0.85)	\$ (0.52)	\$ (0.49)
Weighted average number of outstanding shares	21,065,373	15,065,240	21,095,092	15,065,240

The accompanying notes are an integral part of these statements.

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

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30 -----	
	2003	2002

	(IN THOUSANDS, EXCEPT SHARE DATA)	
Cash flows from operating activities		
Net loss	\$(21,602)	\$(12,819)
	-----	-----
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	402	433
Amortization of deferred debt discount and private offering costs	11,683	4,375
Amortization of deferred product acquisition costs	23	18
Debentures and stock issued for interest	1,459	1,081
Loss on disposal of assets	5	19
Increase in fair value of warrants	92	--
Changes in assets and liabilities		
Accounts receivable	(1,295)	(1,103)
Inventories	(252)	241
Prepaid expenses and other current assets	(292)	(79)
Other assets and deposits	48	119
Accounts payable	(310)	338
Accrued expenses	1,279	1,048
	-----	-----
Total adjustments	12,842	6,490
	-----	-----
Net cash used in operating activities	(8,760)	(6,329)
	-----	-----
Cash flows from investing activities		
Capital expenditures	(719)	(203)
	-----	-----
Net cash used in investing activities	(719)	(203)
	-----	-----
Cash flows from financing activities		
Proceeds from issuance of debentures	500	--
Proceeds from issuance of bridge loans	--	6,500
Payments to Department of Justice	(162)	(155)
Payments on notes payable and capital lease obligations	(20)	(10)
	-----	-----
Net cash provided by financing activities	318	6,335
	-----	-----
NET DECREASE IN CASH	(9,161)	(197)
	-----	-----
Cash at beginning of period	9,211	442
	-----	-----
Cash at end of period	\$ 50	\$ 245
	=====	=====
Cash paid for interest	\$ 400	\$ 21
	=====	=====

Supplemental disclosures of noncash investing and financing activities for the six months ended June 30, 2003:

1. The Company issued \$1,459 of Debentures as payment of like amounts of Debenture accrued interest.
2. The Company has repaid \$1,064 of indebtedness in the form of product deliveries.
3. The Company issued 645,000 warrants with an estimated relative fair value of \$581 for the lending commitment in the form of debentures.
4. The Company issued 59,769 shares of common stock upon the conversion of \$35 of Debentures.
5. Equipment financed through capital leases aggregated approximately \$111.

The accompanying notes are an integral part of these statements.

HALSEY DRUG CO., INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
SIX MONTHS ENDED JUNE 30, 2003
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	COMMON STOCK \$.01 PAR VALUE		ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	TOTAL
	SHARES	AMOUNT			
Balance January 1, 2003	21,035,323	\$ 211	\$ 148,611	\$ (161,090)	\$ (12,268)
Net loss for the six months ended June 30, 2003				(21,602)	(21,602)
Conversion of debentures	59,769	--	35		35
Increase in fair value of warrants ...			92		92
Issuance of warrants for commitment ..			581		581
Balance at June 30, 2003	<u>21,095,092</u>	<u>\$ 211</u>	<u>\$ 149,319</u>	<u>\$ (182,692)</u>	<u>\$ (33,162)</u>

The accompanying notes are an integral part of this statement.

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

(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND LIQUIDITY MATTERS

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 three and six months ended June 30, 2003, assuming that the Company will continue as a going concern, have been made. The results of operations for the three and six month periods ended June 30, 2003 are not necessarily indicative of the results that may be expected for the full year ended December 31, 2003. 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, 2002 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

At June 30, 2003 the Company had cash and cash equivalents of \$50,000 as compared to \$9,211,000 at December 31, 2002. The Company had working capital deficit at June 30, 2003 of \$2,387,000 and an accumulated deficit of \$(182,692,000). The Company incurred a net loss of \$21,602,000 during the six months ended June 30, 2003.

On December 20, 2002, the Company consummated a private offering of securities for an approximate aggregate purchase price of \$26,394,000 (the "2002 Debenture Offering"). The securities issued in the Offering consisted of 5% convertible senior secured debentures (the "2002 Debentures"). Of the \$26,394,000 in 2002 Debentures issued in the 2002 Debenture Offering, approximately \$15,894,000 of the 2002 Debentures were issued in exchange for the surrender of a like amount of principal and accrued interest outstanding under Company's 10% convertible promissory notes issued pursuant to various working capital bridge loan transactions with Galen Partners III, L.P., Galen International III, L.P., Galen Employee Fund III, L.P. (collectively, "Galen") and certain other lenders, during the period from August 15, 2001 through and including December 20, 2002. The 2002 Debentures, issued at par, will become due and payable as to principal on March 31, 2006. Interest on the principal amount of the 2002 Debentures, at the rate of 5% per annum, is payable on a quarterly basis. Interest on the 2002 Debentures will be substantially paid by the Company's issuance of a debenture instrument substantial identical to the 2002 Debentures issued in the 2002 Debenture Offering, in the principal amount equal to the accrued interest for each quarterly period.

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 from operations. At the Company's request, on May 5, 2003, the Company received a letter executed by each of Care Capital Investments II, L.P., Galen Partners III, L.P. and Essex Woodlands Health Ventures V, L.P. (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"). The Letter of Support provides that the amount of any funding provided by the Majority 2002 Debentureholders would be reduced to the extent of any funding obtained by the Company from third-party sources during 2003. The Letter of Support further provides that the terms of any funding provided by the Majority 2002 Debentureholders would be subject to negotiation between the Company and the Majority 2002 Debentureholders at the time of any funding. In consideration for the issuance of the Letter of Support, the Company authorized the issuance of warrants to the Majority 2002 Debentureholders exercisable for an

aggregate of 645,000 shares of the Company's Common Stock at an exercise price of \$.34 per share (which is equivalent to the conversion price of the 2002 Debentures), subject to downward adjustment 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 convertible securities, in a third part investment if lower than the exercise price of the warrants.

As of August 13, 2003, the Majority 2002 Debentureholders had advanced an aggregate of \$2,400,000 to the Company under the Letter of Support to fund the Company's operating losses and capital requirements (the "Letter of Support Advances"). The Letter of Support Advances were made in accordance with the terms of 2002 Debenture Purchase Agreement resulting in the Company's issuance of 2002 Debentures in an aggregate principal amount of \$2,400,000 having a maturity date of March 31, 2006 After giving effect to the Letter of Support Advances made through August 13, 2003, there remains \$6,200,000 available for advance to the Company by the Majority 2002 Debentureholders under the Letter of Support. All additional advances to be made by the Majority 2002 Debentureholders under the Letter of Support will be made in accordance with the 2002 Debenture Purchase Agreement.

The Company believes that the funding to be provided under the Letter of Support combined with cash flow from operations, will be sufficient to satisfy the Company's working capital requirements through January 1, 2004.

In the absence of continued support by the Majority 2002 Debentureholders under the Letter of Support or an alternative third-party investment, or in the event of a material reduction in the Company's cash flow from operations, the Company will be required to (i) delay or cease the continued development of its licensed technologies and the completion of planned capital expenditures, (ii) 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, (iii) significantly scale back or terminate operations and/or (iv) seek protection under applicable bankruptcy laws. An extended delay or a cessation of the Company's continuing development efforts related to its opiate synthesis 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 - 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.

	FOR THE SIX MONTHS ENDED JUNE 30,		FOR THE THREE MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002

	IN THOUSANDS, EXCEPT PER SHARE DATA			
Net loss, as reported	\$(21,602)	\$(12,819)	\$(11,027)	\$ (7,340)
Deduct: Total stock-based employee compensation expense determined under the fair value-based method for all rewards	(382)	(514)	(188)	(258)

Pro forma net loss	\$ (21,984)	\$ (13,333)	\$ (11,215)	\$ (7,598)
	=====			
Loss per share:				
Basic and diluted - as reported	\$ (1.03)	\$ (.85)	\$ (.52)	\$ (.49)
	=====			
Basic and diluted - pro forma	\$ (1.05)	\$ (.89)	\$ (.53)	\$ (.50)
	=====			

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 3 - EARNINGS (LOSS) PER SHARE

The computation of basic earnings (loss) per share of common stock is based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share is based on basic earnings per share adjusted for the effect of other potentially dilutive securities. Excluded from the 2003 and 2002 computations are approximately 224,500,000 and 60,720,000, respectively, of outstanding warrants, options and the effect of convertible debentures and convertible bridge loans outstanding, as such inclusion which would be antidilutive

NOTE 4 - NEW ACCOUNTING PRONOUNCEMENTS

In April 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145"). This statement eliminates the requirement to report gains and losses from extinguishment of debt as extraordinary unless they meet the criteria of APB Opinion 30. SFAS No. 145 also requires sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The changes related to lease accounting are effective for transactions occurring after May 15, 2002 and the changes related to debt extinguishment are effective for fiscal years beginning after May 15, 2002. The impact of adopting the provisions related to lease accounting did not have a material impact on the Company's financial position or results of operations. The Company early adopted the provisions related to debt extinguishments during the year ended December 31, 2002. The adoption did not have a material impact on the Company's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 nullifies Emerging Issues Task Force Issue No. 94-3 and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This statement also establishes that fair value is the objective for initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The impact of the adoption of SFAS No. 146 did not have a material impact on the Company's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN No. 45"). FIN No. 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN No. 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN No. 45 are effective for any guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN No. 45 did not have a material impact on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS No. 148") to provide alternative methods of transition for an entity that voluntarily changes to the fair value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations as provided for under SFAS No. 148. Accordingly, compensation expense is only recognized when the market value of the Company's stock at the date of the grant exceeds the amount an employee must pay to acquire the stock. The adoption of SFAS No. 148 did not have a material impact on the Company's financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FIN No. 46") 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. FIN No. 46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company has adopted FIN No. 46 effective January 31, 2003. The adoption of FIN No. 46 did not have a material impact on the Company's financial position or results of operations.

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 Company is currently evaluating the effect of the adoption of SFAS No. 149 on its financial position and 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 Company is currently evaluating the effect of the adoption of SFAS No. 150 on its financial position and results of operations.

NOTE 5 - STRATEGIC ALLIANCE WITH WATSON PHARMACEUTICALS

On March 29, 2000, the Company completed various strategic alliance transactions with Watson Pharmaceuticals, Inc. ("Watson"). The transactions provided for Watson's purchase of a certain pending abbreviated new drug application ("ANDA") from the Company for \$13,500,000, for Watson's rights to negotiate for Halsey to manufacture and supply certain identified future products to be developed by Halsey, for Watson's marketing and sale of the Company's core products and for Watson's extension of a \$17,500,000 term loan to the Company (See Note 8).

As part of the strategic alliance transactions, the Company and Watson completed a manufacturing and supply agreement providing for Watson's marketing and sale of the Company's existing core products portfolio (the "Core Products Supply Agreement"). The Core Products Supply Agreement obligated Watson to purchase a minimum amount of approximately \$3,060,000 per quarter (the "Minimum Purchase Amount") in core products from the Company, through September 30, 2001 (the "Minimum Purchase Period"). At the expiration of the initial Minimum Purchase Period, if Watson did not continue to satisfy the Minimum Purchase Amount, the Company would then be able to market and sell the core products on its own or through a third party. On August 8, 2001, the Company and Watson executed an amendment to the Core Products Supply Agreement providing (i) for a reduction of the Minimum Purchase Amount from \$3,060,000 to \$1,500,000 per quarter, (ii) for an extension of the Minimum Purchase Period from the quarter ended September 30, 2001 to the quarter ended 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 part of the completion of the 2002 Debenture Offering (See Note 1), on December 20, 2002, the Company and Watson further amended the Core Products Supply Agreement to provide for the Company's satisfaction of its outstanding payment obligations to Watson of \$3,901,331 under such Agreement by the capitalization of such payment obligation as part of the principal under the term loan with Watson (the "Watson Term Loan") (See Note 8). As a result, the Watson Term Loan was amended to increase the principal amount of the Watson Term Loan from \$17,500,000 to \$21,401,331. In addition, the maturity date of Watson Term Loan was extended from March 31, 2003 to March 31, 2006.

In March 2003, the Company notified Watson that the Company intended to commence selling the core products independent of, and in addition to, Watson's efforts as provided for under the Core Products Agreement.

NOTE 6 - INVENTORIES

Inventories consist of the following:

	JUNE 30, 2003	DECEMBER 31, 2002
	-----	-----
	(IN THOUSANDS)	
Finished Goods.....	\$ 88	\$ --
Work in Process.....	680	831
Raw Materials.....	1,769	1,454
	-----	-----
	\$ 2,537	\$ 2,285
	=====	=====

NOTE 7 - CONVERTIBLE SUBORDINATED DEBENTURES

Convertible Subordinated Debentures consist of the following:

	JUNE 30, 2003	DECEMBER 31, 2002
	-----	-----
	(IN THOUSANDS)	
1998 Debentures.....	\$ 30,835	\$ 30,215
1999 Debentures.....	20,991	20,509
2002 Debentures.....	26,716	26,394
2003 Debentures.....	500	--
	-----	-----
	79,042	77,118
Less: Debt discount.....	(62,578)	(73,955)
	-----	-----
	\$ 16,464	\$ 3,163
	=====	=====

During the six months ended June 30, 2003, the Company issued \$1,959,000 in new debentures of which \$1,459,000 was issued as payment of accrued interest in the same amount of these debentures and \$500,000 was issued under the Letter of Support Advances. Such accrued interest debentures are convertible into 1,512,000 shares of the Company's common stock at conversion prices of \$1.02 and \$.93. The Debentures issued under the Letter of Support Advances are convertible into 625,000 shares of the Company's common stock at a conversion price of \$.80. As the conversion price of such debentures was equal to or exceeded the fair market value of the Company's common stock on the date of issue, no beneficial conversion features were determined to exist. During the six months ended June 30, 2002, the Company issued \$538,000 in new debentures as payment of accrued interest in the same amount of these debentures. Such debentures are convertible into 289,247 shares of the Company's common stock at a conversion price of \$1.86.

As a result of the issuance of the 2003 Debentures, certain existing warrants agreements were modified as a result of dilution adjustment provisions contained within. The Company recorded a charge to earnings of \$92,000 related to the increase in the fair value of the warrants, as calculated using the Black - Scholes option-pricing model, as a result of the modification of terms.

During the six months ended June 30, 2003, debentures in the principal amount of \$35,000 were converted into 59,769 shares of the Company's common stock.

Related-Party Transactions

Certain of the 1998 Debentures and 1999 Debentures are held by members of the Company's management and Board of Directors. The aggregate principal amount of such debentures was approximately \$372,000 and \$364,000 at June 30, 2003 and December 31, 2002, respectively. Interest expense on these debentures was approximately \$9,200 and \$8,600, for the six months ended June 30, 2003 and 2002, respectively, of which approximately \$8,000 for each six-month period was paid through the issuance of like debentures. Interest expense on these debentures was approximately \$4,600 and \$4,300, for the three months ended June 30, 2003 and 2002, respectively, of which approximately \$4,000 for each three month period was paid through the issuance of like debentures.

NOTE 8 - TERM NOTE PAYABLE

In connection with various strategic alliance transactions (See Note 5), Watson advanced \$17,500,000 to the Company under the Watson 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, and carries a floating rate of interest equal to prime plus two percent and had an original maturity date of March 31, 2003. 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 \$21,401,331 to reflect the inclusion of the Company's payment obligations under the Core Products Supply Agreement between Watson and the Company. The interest rate at June 30, 2003 was 8.5% and at December 31, 2002 was 8.75%. 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 \$.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 June 30, 2003, Watson has advanced \$21,401,331 to the Company under the Watson Term Loan.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Employment contracts

In June 2003, an employment agreement of an officer/employee was terminated. Pursuant to provisions of the employment agreement, the Company has provided for approximately \$500,000 of salary and benefits under this agreement. The salary benefit is payable in a lump sum cash payment within thirty (30) days of the date of termination. The Company has not made any salary or benefit payments to the individual under this agreement. The Company and the terminated employee are currently negotiating a separation agreement.

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 Company's insurance carrier assumed the defense of all such matters, and the carrier has settled a substantial number. Currently, several actions remain pending with the Company as a defendant in the Pennsylvania Court of Common Pleas, Philadelphia Division, and the insurance carrier is defending each action. The Company and its legal counsel do 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 condensed consolidated financial statements.

In May 2003, the Company was notified that the Company, as well as numerous other pharmaceutical manufacturers and distributors, was a named defendant in a lawsuit involving a product liability claim. The claim has been submitted and accepted by Company's insurance carrier for defense. The final outcome of this lawsuit cannot be determined at this time, and accordingly, no adjustment has been made to the condensed 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 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 has been completed. It is the Company's expectation to file for summary judgment in this action. In the event the Company is unsuccessful in its motion for summary judgment, a trial on this action will follow. 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 condensed consolidated financial statements.

In addition, the Company is a party to legal matters arising in the general conduct of business. The ultimate outcome of such matters is not expected to have a material adverse effect on the Company's results of operations or financial position.

Indemnifications

Each of the purchase agreements for the 1998 Debentures, 1999 Debentures and the 2002 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, disbursements, arising out of or resulting from the breach of any representation, warranty, or agreement, of the Company related to purchase of the debentures. These indemnification obligations do not include a limit, or maximum potential future payments, nor are there any recourse provisions or collateral that may offset the cost. As of June 30, 2003 the Company has not recorded a liability for any obligations arising as a result of these indemnification agreements.

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

SIX MONTHS ENDED JUNE 30, 2003 VS. SIX MONTHS ENDED JUNE 30, 2002

NET PRODUCT REVENUES

The Company's net product revenues for the six months ended June 30, 2003 of \$2,732,000 represents a decrease of \$1,407,000 (34%) as compared to net revenues for the six months ended June 30, 2002 of \$4,139,000. The decrease in net product revenues is a result of a decrease in sales to the Company's primary customer, Watson Pharmaceuticals, Inc. which is pursuing a sales strategy that places less emphasis on the products we provide. During the first quarter 2003, the Company initiated steps to reestablish internal sales efforts so as to become less dependent upon a single customer. The Company expects this strategy to materialize in the third and fourth quarters of 2003.

COST OF MANUFACTURING

For the six months ended June 30, 2003, cost of manufacturing decreased \$1,116,000 as compared to the six months ended June 30, 2002. As a percentage of sales, cost of manufacturing was 188% and 151% for the six months ended June 30, 2003 and 2002, respectively. The decrease was a result of reduced net product revenues as noted above, as well as decreased reliance on third party outside testing laboratories of \$132,000 offset by increases in quality control labor costs of \$80,000. Additionally, direct labor savings of \$157,000 was created from the consolidation of the Company's multi-site packaging operations which occurred during the second quarter of 2002.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses as a percentage of sales for the six months ended June 30, 2003 and 2002 were 143% and 85%, respectively. Overall these expenses in the first six months of 2003 increased \$402,000 or 11% from the same period in 2002. The increase is a result of increases in payroll and payroll related costs of \$217,000, payroll severance costs of \$500,000 and Company insurance premiums of \$130,000 offset by reduction in legal expenditures of \$245,000 and product marketing expenses of \$200,000 during the six month period ended June 30, 2003.

RESEARCH AND DEVELOPMENT EXPENSES

The Company currently conducts research and development activities at each of its Congers, New York and Culver, Indiana facilities. The Company's research and development activities consist primarily of the development of the Company's Opiate Synthesis Technologies, including the development for sale of new chemical products and the development of Active Pharmaceutical Ingredients ("APIs"), as well as new generic drug product development efforts and manufacturing process improvements. New drug product development activities are primarily directed at conducting research studies to develop generic drug formulations, reviewing and testing such formulations for therapeutic equivalence to brand name products and additional testing in areas such as bioavailability, bioequivalence and shelf-life. During 2003, the Company's research and development efforts will cover finished dosage products and APIs in a variety of therapeutic applications, with an emphasis on pain management products. Research and development expenses decreased \$141,000 from the same period in 2002. Research and development expenses as a percentage of sales for the six months ended June 30, 2003 and 2002 were 23% and 18%, respectively.

The Company is proceeding with the development of products, apart from those obtained from Barr Laboratories, for submission to the FDA. During fiscal 2003, the Company anticipates the submission of four ANDA supplements or amendments to the FDA. The supplements and amendments relate to the transfer of existing ANDAs from the Company's former Brooklyn facility to its Congers facility as well as the transfer of certain ANDAs obtained from Barr Laboratories. Although the Company has been successful in receiving ANDA approvals since its release from the FDA's Application Integrity Policy list in December 1996, there can be no assurance that any newly submitted ANDAs, or supplements or amendments thereto or those contemplated to be submitted, will be approved by the FDA.

The Company is performing the necessary regulatory steps to effect the transfer of certain 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 2003, although no assurance can be given that any of the Barr Products will receive FDA approval or that if approved, that the Company will be successful in the manufacture and sale of the such products. It is the Company's intention to continue to evaluate the remaining Barr Products on an ongoing basis to assess their prospects for commercialization and likelihood of obtaining regulatory approval.

The Company is continuing development efforts relating to certain API's. In the last few years, the Company has increased its efforts to develop and manufacture APIs, also known as bulk chemical products. It is the Company's expectation that beginning in fiscal 2004, the internally developed APIs will assist in the expansion of the Company's line of finished dosage products. The Company currently manufactures two API's and has seven others under development.

NET LOSS

For the six months ended June 30, 2003, the Company had net loss of \$21,602,000 as compared to a net loss of \$12,819,000 for the six months ended June 30, 2002. Included in net loss for the six months ended June 30, 2003, was interest expense of \$2,904,000 and amortization of deferred debt discount and private offering costs of \$11,683,000, as compared to \$2,173,000 and \$4,375,000, respectively, over the same period in 2002. Also included in net loss for the six months ended June 30, 2003, was a charge to earnings of \$92,000 related to the increase in fair value of warrants, as calculated using the Black-Scholes option-pricing model, as a result of the modification of terms from the issuance of the 2003 debentures.

THREE MONTHS ENDED JUNE 30, 2003 VS. THREE MONTHS ENDED JUNE 30, 2002

NET PRODUCT REVENUES

The Company's net product revenues for the three months ended June 30, 2003 of \$1,206,000 represents a decrease of \$1,052,000 (47%) as compared to net revenues for the three months ended June 30, 2002 of \$2,258,000.

The decrease in net product revenues is a result of a decrease in sales to the Company's primary customer, Watson Pharmaceuticals, Inc. which is pursuing a sales strategy that places less emphasis on the products we provide. During the first quarter 2003, the Company initiated steps to reestablish internal sales efforts so as to become less dependent upon a single customer. The Company expects this strategy to materialize in the third and fourth quarters of 2003.

COST OF MANUFACTURING

For the three months ended June 30, 2003, cost of manufacturing decreased \$1,088,000 as compared to the three months ended June 30, 2002. As a percentage of sales, cost of manufacturing was 188% and 149% for the three months ended June 30, 2003 and 2002, respectively. The decrease was a result of reduced net product revenues as noted above, as well as the decreased reliance on third party outside testing laboratories of \$68,000 offset by increases in quality control payroll and payroll related costs of \$99,000. Additionally, direct labor savings of \$64,000 was created from the consolidation of the Company's multi-site packaging operations, which occurred during the second quarter of 2002.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses as a percentage of sales for the three months ended June 30, 2003 and 2002 were 183% and 84%, respectively. Overall, these expenses for the three month period ended June 30, 2003 increased \$307,000 or 16% from the same period in 2002. The increase is a result of increases in payroll severance costs of \$500,000 offset by decreases in product marketing expenses of 193,000 during the three month period ended June 30, 2003.

RESEARCH AND DEVELOPMENT EXPENSES

The Company currently conducts research and development activities at each of its Congers, New York and Culver, Indiana facilities. The Company's research and development activities consist primarily of the development of the Company's Opiate Synthesis Technologies, including the development for sale of new chemical products and the development of APIs, as well as new generic drug product development efforts and manufacturing process improvements. New drug product development activities are primarily directed at conducting research studies to develop generic drug formulations, reviewing and testing such formulations for therapeutic equivalence to brand name products and additional testing in areas such as bioavailability, bioequivalence and shelf-life. During 2003, the Company's research and development efforts will cover finished dosage products and APIs in a variety of therapeutic applications, with an emphasis on pain management products. Research and development expenses decreased \$98,000 from the same period in 2002. Research and development expenses as a percentage of sales for the three months ended June 30, 2003 and 2002 was 24% and 17%, respectively.

The Company is proceeding with the development of products, apart from those obtained from Barr Laboratories, for submission to the FDA. During fiscal 2003, the Company anticipates the submission of four ANDA supplements or amendments to the FDA. The supplements and amendments relate to the transfer of existing ANDAs from the Company's former Brooklyn facility to its Congers facility as well as the transfer of certain ANDAs obtained from Barr Laboratories. Although the Company has been successful in receiving ANDA approvals since its release from the FDA's Application Integrity Policy list in December 1996, there can be no assurance that any newly submitted ANDAs, or supplements or amendments thereto or those contemplated to be submitted, will be approved by the FDA.

The Company is performing the necessary regulatory steps to effect the transfer of certain 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 2003, although no assurance can be given that any of the Barr Products will receive FDA approval or that if approved, that the Company will be successful in the manufacture and sale of the such products. It is the Company's intention to continue

to evaluate the remaining Barr Products on an ongoing basis to assess their prospects for commercialization and likelihood of obtaining regulatory approval.

The Company is continuing development efforts relating to certain API's. In the last few years, the Company has increased its efforts to develop and manufacture APIs, also known as bulk chemical products. It is the Company's expectation that beginning in fiscal 2004, the internally developed APIs will assist in the expansion of the Company's line of finished dosage products. The Company currently manufactures two API's and has seven others under development.

NET LOSS

For the three months ended June 30, 2003, the Company had net loss of \$11,027,000 as compared to a net loss of \$7,340,000 for the three months ended June 30, 2002. Included in net loss for the three months ended June 30, 2003, was interest expense of \$1,471,000 and amortization of deferred debt discount and private offering costs of \$5,916,000, as compared to \$1,135,000 and \$2,840,000, respectively, over the same period in 2002. Also included in net loss for the three months ended June 30, 2003, was a charge to earnings of \$92,000 related to the increase in fair value of warrants, as calculated using the Black-Scholes option-pricing model, as a result of the modification of terms from the issuance of the 2003 debentures.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2003 the Company had cash and cash equivalents of \$50,000 as compared to \$9,211,000 at December 31, 2002. The Company had a working capital deficit at June 30, 2003 of \$2,387,000 and working capital at December 31, 2002 of \$5,933,000.

On December 20, 2002, the Company consummated a private offering of securities for an approximate aggregate purchase price of \$26,394,000 (the "2002 Debenture Offering"). The securities issued in the 2002 Debenture Offering consisted of 5% convertible senior secured debentures (the "2002 Debentures"). Of the \$26,394,000 in 2002 Debentures issued in the 2002 Debenture Offering, approximately \$15,894,000 of the 2002 Debentures were issued in exchange for the surrender of a like amount of principal and accrued interest outstanding under Company's 10% convertible promissory notes issued pursuant to various working capital bridge loan transactions with Galen and certain other lenders, during the period from August 15, 2001 through and including December 20, 2002. The 2002 Debentures, issued at par, will become due and payable as to principal on March 31, 2006. The 2002 Debentures were issued pursuant to a certain Debenture Purchase Agreement dated December 20, 2002 (the "Purchase Agreement") by and among the Company, Care Capital Investments II, LP ("Care Capital"), Essex Woodlands Health Ventures V, L.P. ("Essex"), Galen and each of the purchasers listed on the signature page thereto.

The Debentures issued to each of Care Capital and Essex are convertible at any time after issuance into shares of the Company's Common Stock. The 2002 Debentures issued to Galen and the other investors in the 2002 Debenture Offering (excluding Care Capital and Essex) are convertible at any time after the approval of the Company's shareholders and debentureholders of an amendment to the Company's Certificate of Incorporation to increase its authorized shares of Common Stock from 80,000,000 shares to such number of shares as shall provide sufficient authorized shares to permit the conversion of the 2002 Debentures and the Company's other outstanding convertible securities. Subject to the foregoing, the 2002 Debentures are convertible into shares of Common Stock at a price per share (the "Conversion Price") of \$.34. Until such time as the Company completes a Subsequent Material Offering (as defined below) the 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 option for the purchase of, or stock or other securities convertible into, Common Stock ("Convertible Securities"), if lower than the then applicable Conversion Price. Following the Company's completion of a Subsequent Material Offering, the Conversion Price is subject to adjustment from time to time on a weighted-average dilution basis. A "Subsequent Material Offering" is the grant or issuance of Common

Stock or Convertible Securities by the Company during any six (6) month period for an aggregate gross consideration of at least \$10,000,000. Assuming the conversion of the 2002 Debentures at the initial Conversion Price of \$.34 per share, the 2002 Debentures are convertible into an aggregate of approximately 77,629,000 shares of Common Stock.

The Interest Debentures are convertible at anytime after issuance into shares of Common Stock at a price per share equal to the closing bid and asked prices of the Common Stock for the trading day immediately preceding the applicable interest payment date under the 2002 Debentures, as reported by the Over-the-Counter ("OTC") Bulletin Board.

The Purchase Agreement provides that the holders of the 2002 Debentures shall have the right to vote as part of a single class with all holders of the Company's Common Stock on all matters to be voted upon by such stockholders. Each 2002 Debentureholder shall have such number of votes as shall equal the number of votes he would have had if such holder converted the entire outstanding principal amount of his 2002 Debenture into shares of Common Stock immediately prior to the record date relating to such vote; provided, however, that any Debentures initially held by Care Capital shall, for so long as they are held by Care Capital, have no voting rights.

The 2002 Debentures are secured by a lien on all assets of the Company, tangible and intangible. In addition, each of Houba, Inc. and Axiom Pharmaceutical Corporation, each a wholly-owned subsidiary of the Company, has executed in favor of the holders of the 2002 Debentures an unconditional agreement of guarantee of the Company's obligations under the Purchase Agreement. Each guarantee is secured by all assets of such subsidiary, and, in the case of Houba, Inc., by a mortgage lien on its Culver, Indiana real estate. In addition, the Company has pledged the stock of each such subsidiary to the holders of the 2002 Debentures to further secured its obligations under the Purchase Agreement.

In accordance with the terms of a Subordination Agreement dated December 20, 2002 between the Company, the holders of the 2002 Debentures, the holders of the Existing Debentures and Watson Pharmaceuticals, Inc. ("Watson"), the liens on the Company's and its subsidiaries' assets as well as the payment priority of the 2002 Debenture are (i) subordinate to the Company's lien and payment obligations in favor of Watson under the Watson Term Loan (as defined below), and (ii) senior to the Company's lien and payment obligations in favor of holders of the Existing Debentures in the aggregate principal amount of approximately \$50,724,000.

Of the \$26,394,000 in Debentures issued in the Offering, approximately \$15,894,000 Debentures were issued in exchange for the surrender of a like amount of principal and accrued interest on the Company's outstanding 10% convertible promissory notes issued pursuant to various working capital bridge loan transactions with Galen and the certain other lenders during the period from August 15, 2001 through and including December 20, 2002.

In connection with various strategic alliance transactions with Watson, \$17,500,000 was advanced to the Company under a term loan (the "Watson 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, and carried a floating rate of interest equal to prime plus two percent and had an original maturity date of March 31, 2003. 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 \$21,401,331 to reflect the inclusion of the Core Products Supply Agreement advance payments. The interest rate at June 30, 2003 and December 31, 2002 was 8.50% and 8.75%, respectively. 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 \$.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 June 30, 2003, Watson has advanced \$21,401,331 to the Company under the Watson Term Loan.

The development and commercialization of APIs and finished dosage products incorporating the Opiate Synthesis Technologies are subject to various factors, many of which are outside the Company's control. Specifically, the Opiate Synthesis Technologies have been tested only in laboratory settings and will need to be successfully "scaled up" in order to be commercially viable, of which no assurance can be given. Additionally, the Company must satisfy, and continue to maintain compliance with, the DEA's requirements for the maintenance of its Manufacturing Registration and the issuance and maintenance of the Import Registration. The process of seeking the Import Registration and contesting opposition proceedings, as well as the continuing development of the Opiate Synthesis Technologies, will likely continue through 2004. The Company is currently unable to provide any assurance that the Opiate Synthesis Technologies will be commercially viable or that the Company will succeed in obtaining the Import Registration. The Company is committing the substantial majority of its resources, available capital and cash flow from operations to the development of the Opiate Synthesis Technologies and to the receipt of the Import Registration. The failure of the Company to successfully develop the Opiate Synthesis Technologies or to obtain the Import Registration 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 Opiate 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 Opiate Synthesis Technologies.

The Company has budgeted approximately \$2,500,000 in 2003 for the continued development and commercialization of the Opiate Synthesis Technologies. Of such amount, approximately \$2,000,000 relates to capital expenditures for facility improvements and the purchase of equipment at the Company's Culver, Indiana facility, approximately \$300,000 relates to capital expenditures for environmental compliance waste discharge storage tanks at the Culver facility, and approximately \$200,000 relates to the legal fees and related expenses for the OALJ hearing and third party opposition proceedings in connection with the Company's application for the Import Registration. Until such time as the Company successfully develops and commercializes new finished dosage products and APIs, of which there can be no assurance, the majority of the Company's revenues are expected to be derived from the Core Products Supply Agreement with Watson, with the balance of the Company's revenues derived from a combination of the Company's own selling efforts for the Company's core products, which sales efforts commenced in the second quarter of 2003, and the Company's manufacture of non-core products for third parties. The Company estimates that during 2003 and 2004, the Company will continue to incur operating losses and negative cash flow.

At the Company's request, on May 5, 2003, the Company received a letter executed by each of Care Capital, Galen 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"). The Letter of Support provides that the amount of any funding provided by the Majority 2002 Debentureholders would be reduced to the extent of any funding obtained by the Company from third-party sources during 2003. The Letter of Support further provides that the terms of any funding provided by the Majority 2002 Debentureholders would be subject to negotiation between the Company and the Majority 2002 Debentureholders at the time of any funding. In consideration for the issuance of the Letter of Support, the Company authorized the issuance of warrants to the Majority 2002 Debentureholders exercisable for an aggregate of 645,000 shares of the Company's Common Stock at an exercise price of \$.34 per share (which is equivalent to the conversion price of the 2002 Debentures), subject to downward adjustment 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 convertible securities, in a third part investment if lower than the exercise price of the warrants.

As of August 13, 2003, the Majority 2002 Debentureholders had advanced an aggregate of \$2,400,000 to the Company under the Letter of Support to fund the Company's operating losses and capital requirements (the "Letter of Support Advances"). The Letter of Support Advances were made in accordance with the terms of 2002 Debenture Purchase Agreement resulting in the Company's issuance of 2002 Debentures in an aggregate principal amount of \$2,400,000 having a maturity date of March 31, 2006. After giving effect to the Letter of Support Advances made through August 13, 2003, there remains \$6,200,000 available for advance to the Company by the Majority 2002

Debentureholders under the Letter of Support. All additional advances to be made by the Majority 2002 Debentureholders under the Letter of Support will be made in accordance with the 2002 Debenture Purchase Agreement.

The Company believes that the funding to be provided under the Letter of Support combined with cash flow from operations, will be sufficient to satisfy the Company's working capital requirements through January 1, 2004.

In the absence of continued funding by the Majority 2002 Debentureholders under the Letter of Support or an alternative third-party investment, or in the event of a material reduction in the Company's cash flow from operations, the Company will be required to (i) significantly curtail product commercialization efforts, including the development and commercialization of the Opiate Synthesis Technologies, (ii) if available, obtain funding through arrangements with collaborative partners or others on terms that may require the Company to relinquish certain rights to its Opiate Synthesis Technologies, which the Company would otherwise pursue on its own or that would dilute the Company's stockholders, (iii) significantly scale back or terminate operations and/or (iv) seek protection under applicable bankruptcy laws. An extended delay in obtaining necessary financing will result in the cessation of the Company's continuing development efforts related to its Opiate Synthesis Technologies and will have a material adverse effect on the Company's financial condition and results of operations.

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 comply 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.

NEW ACCOUNTING PRONOUNCEMENTS

In April 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145"). This statement eliminates the requirement to report gains and losses from extinguishment of debt as extraordinary unless they meet the criteria of APB Opinion 30. SFAS No. 145 also requires sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The changes related to lease accounting are effective for transactions occurring after May 15, 2002 and the changes related to debt

extinguishment are effective for fiscal years beginning after May 15, 2002. The impact of adopting the provisions related to lease accounting did not have a material impact on the Company's financial position or results of operations. The Company early adopted the provisions related to debt extinguishments during the year ended December 31, 2002. The adoption did not have a material impact on the Company's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 nullifies Emerging Issues Task Force Issue No. 94-3 and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. This statement also establishes that fair value is the objective for initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The impact of the adoption of SFAS No. 146 did not have a material impact on the Company's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN No. 45"). FIN No. 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN No. 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN No. 45 are effective for any guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN No. 45 did not have a material impact on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS No. 148"), to provide alternative methods of transition for an entity that voluntarily changes to the fair value-based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations as provided for under SFAS No. 148. Accordingly, compensation expense is only recognized when the market value of the Company's stock at the date of the grant exceeds the amount an employee must pay to acquire the stock. The adoption of SFAS No. 148 did not have a material impact on the Company's financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" ("Fin No. 46"). 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. FIN No. 46's consolidation requirements apply immediately to variable interest entities created or acquired after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company has adopted FIN No. 46 effective January 31, 2003. The adoption of FIN No. 46 did not have a material impact on the Company's financial position or results of operations.

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 Company is currently evaluating the effect of the adoption of SFAS No. 149 on its financial position and 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 period beginning after June 15, 2003. The Company is currently evaluating the effect of the adoption of SFAS No. 150 on its financial position and results of operations.

ITEM 4. CONTROLS AND PROCEDURES

As of June 30, 2003, Peter A. Clemens, as the acting principal executive officer and the principal financial officer of the Company has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (Exchange Act)). Based upon that evaluation, the acting principal executive officer and the principal financial officer of the Company has concluded that such disclosure controls and procedures are effective in timely alerting them to any material information relating to the Company and its consolidated subsidiaries required to be included in the Company's reports filed or submitted with the Securities and Exchange Commission under the Exchange Act.

PART II

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the quarter ended June 30, 2003, the Company issued (i) 5% Convertible Senior Secured Debentures in the principal amount of approximately \$860,000 in satisfaction of accrued interest on Company's outstanding 5% Convertible Senior Secured Debentures issued in 1998, 1999 and 2002 (the "Convertible Debentures") and (ii) 645,000 common stock purchase warrants to the 2002 Majority Debentureholders pursuant to the May 5, 2003 Letter of Support (the "Commitment Warrants").

During the quarter ended June 30, 2003, Debentures of \$35,000 were converted into 59,769 shares of the Company's common stock.

Each of the holders of the Convertible Debentures for which interest payments were made in 5% Convertible Senior Secured Debentures and the 2002 Majority Debentureholders receiving the Commitment Warrants are accredited investors as defined in Rule 501(a) of Regulation D promulgated under the Securities Act of 1933, as amended (the "Act"). The 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 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

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 May 9, 2003 related to its financial results for the year ended December 31, 2002.

The Company filed a Current Report on Form 8-K dated May 22, 2003 related to the appointment of Jerry Karabelas as Chairman of the Board of Directors of the Company and the retirement of Michael Reicher as Chairman and Chief Executive Officer.

The Company did not file any other Reports on Form 8-K during the quarter ended June 30, 2003.

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 13, 2003

HALSEY DRUG CO., INC.

By/s/ Peter A. Clemens

Peter A. Clemens
Acting Chief Executive Officer

By: /s/ Peter A. Clemens

Peter A. Clemens
VP & Chief Financial Officer

EXHIBIT INDEX

Exhibit - - - - -	Document - - - - -
31.1	Certification of Periodic Report by Acting 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 Acting 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.

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

I, Peter A. Clemens, the Acting 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-15(e) and 15d-15(e) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 and presented in this quarterly our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2003

s/ Peter A. Clemens

Peter A. Clemens
Acting Chief Executive Officer

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-15(e) and 15d-15(e) for the registrant and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - (c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2003

/s/ Peter A. Clemens

Peter A. Clemens
Chief Financial Officer

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, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter A. Clemens, the Acting 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 13, 2003

s/ Peter A. Clemens

Peter A. Clemens
Acting Chief Executive Officer

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, 2003 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 13, 2003

/s/ Peter A. Clemens

Peter A. Clemens
Chief Financial Officer
and Vice President