SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A-2

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

(MARK ONE)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1998

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 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 NORTH PERRYVILLE ROAD, CRIMSON BUILDING NO. 2, ROCKFORD, ILLINOIS 61107
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (815) 399-2060

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS:	NAME OF EACH EXCHANGE ON WHICH REGISTERED:
COMMON STOCK, PAR VALUE $0.01	THE AMERICAN STOCK EXCHANGE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
NONE

NONE
(TITLE OF CLASS)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of March 15, 1999, the registrant had 14,260,711 Common Stock, par value $0.01, outstanding. Based on the closing price of the Common Stock on March 15, 1999 ($1 3/16), the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $16,890,000.

DOCUMENTS INCORPORATED BY REFERENCE
NONE

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Report under the captions Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," Item 1, "Business", Item 3, "Legal Proceedings" and elsewhere in this Report constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Halsey Drug Co., Inc. ("Halsey" or the "Company"), or industry results, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: changes in general economic and business conditions; loss of market share through competition; introduction of competing products by other companies; the timing of regulatory approval and the introduction of new products by the Company; changes in industry capacity; pressure on prices from competition or from purchasers of the Company's products; regulatory changes in the generic pharmaceutical manufacturing industry; regulatory obstacles to the introduction of new products that are important to the Company's growth; availability of qualified personnel; the loss of any significant customers; and other factors both referenced and not referenced in this Report. When used in this Report, the words "estimate," "project," "anticipate," "expect," "intend," "believe," and similar expressions are intended to identify forward-looking statements.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Certain statements set forth under this caption constitute "forward-looking statements" within the meaning of the Reform Act. See "Special Note Regarding Forward-Looking Statements " on page 1 of this Report for additional factors relating to such Statements.

OVERVIEW

The Company reported a net loss of $12,724,000 or $.92 per share for the year ended December 31, 1998 as compared with the net loss of $15,015,000 or $1.12 per share for 1997. Sales for the year ended December 31, 1998 were approximately $8,841,000 as compared to sales of approximately $9,088,000 for 1997. Notwithstanding these results, the Company had the following achievements in 1998:

- Received infusion of capital enabling the Company to settle past obligations and provide for future opportunities.

- Reestablished itself in the marketplace as a dependable supplier of quality products, expanded its customer base and reduced reliance upon a single customer.

- Reestablished relationships with suppliers.

- Received approval from the FDA of two ANDA's, submitted five others for approval and continued development on additional products for submission in 1999.

- Discontinued certain non-core operations and reduced the workforce by approximately 25%.

RESULTS OF OPERATIONS

The following chart reflects expenses, earnings, income, losses and profits expressed as a percentage of net sales for the years 1998, 1997 and 1996.

	PERCENTAGE OF NET SALES YEAR ENDED DECEMBER			PERCENTAGE CHANGE YEAR-TO-YEAR INCREASE (DECREASE) YEARS ENDED DECEMBER 31,	
	1998	1997	1996	1997 TO 1998	1996 TO 1997
Net sales	100%	100%	100.0%	(2.7)	(26.6)
Cost of Goods	143.8	169.5	135.9	(17.5)	(8.47)
Gross Profit	(43.8)	(69.5)	(35.9)	(38.7)	42.1
Research & Development	7.4	10.8	15.0	(33.5)	47.2
Selling, general and administrative expense	91.4	69.4	60.5	29.5	(15.7)
(Loss) from operations	(142.5)	(149.7)	(111.4)	(6.7)	(1.3)
Interest expense	22.0	12.6	13.9	70.1	(33.0)
Other (income) expenses	(20.6)	2.9	(8.2)	--	(126.4)
(Loss) before income taxes	(143.9)	(165.2)	(117.1)	(14.6)	3.6
Net (loss)	(143.9)%	(165.2)%	(117.1)%	(14.6)%	3.6%

NET SALES

Net sales for 1998 of $8,841,000 represents a decrease of $247,000 as compared to net sales for 1997. The decrease is attributable in part to a reduction in toll manufacturing revenue from Mallinckrodt of approximately $878,000 from the prior year. Additionally, the Company was unable to market successfully to the retail pharmacy marketplace until the third quarter of 1998 because during fiscal 1996 and 1997, the Company had failed to pay required rebates to state Medicaid agencies. This caused those states to deny medicaid reimbursement to the retail pharmacies on their sales of the Company's products. Commensurate with the infusion of new capital and management in March, 1998, the Company began reestablishing itself in good standing with all states. In April 1998, the Company entered into a new contract with the Health Care Finance Authority ("HCFA") and paid outstanding rebates due to various states. The states completed the reinstatement of the Company on their medicaid reimbursement by July, 1998. The Company has been in good standing with HCFA and the individual states since July 1998 and expects this past non-compliance will have no impact on future results of operations or liquidity. Also during much of 1998, the Company experienced difficulty in obtaining certain raw materials which reduced sales. These shortages were remedied by December 31, 1998.

Net sales for 1997 of $9,088,000 represents a decreased of $3,291,000 as compared to net sales for 1996. This decrease is primarily attributable to a lack of sufficient working capital necessary to purchase raw materials. Without adequate inventory, the Company was unable to satisfy customer orders in a timely fashion and caused customers to procure products from competitors.

The manufacturing and record keeping problems of the Company that led to its being placed on the FDA's Application Integrity Policy List in 1991 were rectified in 1993 and have no ongoing adverse effect on the Company's current or future expected results of operations or liquidity.

GROSS MARGINS

The Company's gross margin for 1998 of (43.8)% is a 38.7% improvement over gross margin for 1997. This improvement is due, in part, to the elimination of non-core manufacturing operations in California, tighter inventory controls and a general reduction in manufacturing labor. Additionally, the Company's revenues in 1998 from sales to Mallinckrodt under a toll manufacturing agreement decreased by approximately $878,000. The gross margins on these products were substantially less than on the Company's other products.

The Company's gross margin for 1997 of (69.5)% is a 42.1% reduction over gross margin for 1996. This deterioration occurred because the Company failed to react quickly enough to falling sales by decreasing manufacturing expenses. Additionally, the Company incurred approximately $1,572,000 of manufacturing costs in operating non-core facilities that generated sales of only $495,000.

RESEARCH & DEVELOPMENT EXPENSES

For 1998, research and development expenses amounted to $651,000 as compared to $979,000 for 1997. The decrease primarily reflects the costs of biostudies performed in 1997 that were not duplicated in 1998.

For 1997, research and development expenses amounted to $979,000 as compared to $1,854,000 for 1996. This decrease was a result of reductions in personnel necessitated by the Company's liquidity crisis.

The Company expects research and development expenses to increase significantly in 1999 consistent with its plans to increase the number of ANDA submissions as compared to 1998.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative costs were $8,078,000 (91.4% of net sales) for 1998 compared to $6,308,000 (69.4% of net sales) for 1997. This increase is primarily due to costs associated with capital financing ($350,000), legal expenses and settlement costs of certain litigation ($550,000), severance costs associated with personnel reductions ($250,000), installation of a new information system ($100,000) and costs associated with expanded regulatory and compliance departments ($300,000).

Selling, general and administrative costs were $6,308,000 (69.4% of net sales) for 1997 compared to $7,486,000 (60.5% of net sales) for 1996. This decrease is due primarily to a reduction in legal expenses and litigation settlements as compared to 1996.

INTEREST EXPENSE

Interest expense for 1998 increased by 62% over that of 1997 reflecting the substantial new debt in the form of $25,800,000 of convertible debentures that was added in 1998. Interest expense for 1997 decreased 33.0% as compared to 1996 due primarily to the conversion in the latter part of 1996 of $7,740,000 of convertible debentures bearing interest at 10% into common stock. Interest expense for 1996 increased 77.8% as compared to 1995 as a result of a higher level of borrowings due to the issuance of convertible subordinated debentures, as well as fees payable to the Company's banks.

OTHER INCOME

Included in other income for 1998 is $1,900,000 realized from the sale of certain assets to Mallinckrodt. This transaction was entered into in 1997 but the conditions for realization of the gain from the sale were not met until 1998.

PROVISION FOR INCOME TAXES

The Company had no tax (benefit) provision for 1998, 1997 and 1996 since the available loss carry back to prior years was completely utilized by the net operating loss for 1993 carry back to the prior three years. At December 31, 1998, the Company has a Federal tax refund claim of approximately $1,000,000 pending before the tax authorities. In the meantime, the IRS is holding up action to collect approximately $1,300,000 of past due payroll taxes. Additionally, the Company has negotiated payment plans for approximately $500,000 of past due state and local taxes. The Company has net operating loss carryforwards of approximately $45,600,000 which expire in the years 2011 through 2018.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 1998, the Company had cash and cash equivalents of $1,850,000 as compared to $26,000 at December 31, 1997. The Company had a working capital deficit at December 31, 1998 of $(6,665,000).

On March 10, 1998, the Company completed the Offering to Galen Partners III, L.P., Galen Partners International III, L.P., Galen Employee Fund III, L.P. (collectively, "Galen") and each of the Purchasers (along with Galen, collectively the "Galen Investor Group") listed on the signature page to a certain Debenture and Warrant Purchase Agreement dated March 10, 1998 (the "Purchase Agreement"). The net proceeds to the Company from the Offering, after deduction of related Offering expenses, were approximately $19.3 million. The securities issued in the Offering consisted of 5% convertible senior secured debentures (the "Debentures") and common stock purchase warrants (the "Warrants") exercisable for an aggregate of 4,202,020 shares of the Company's common stock. In addition, in accordance with the terms of the Purchase Agreement, the Company granted the Galen Investor Group an option to invest an additional $5 million in the Company at any time within 18 months from the date of the closing of the Offering in exchange for Debentures and Warrants having terms identical to those issued in the Offering (the "Option"). In June 1998, the Galen Investor Group exercised the Option.

The net proceeds of the Offering were, in large part, used to satisfy a substantial portion of the Company's liabilities and accounts payable. Such liabilities include the full satisfaction of the Company's Bank indebtedness and related fees, payment of arrearages in rent to the landlord of the Brooklyn facility and satisfaction of outstanding judgments and liens. Additionally, pursuant to agreements reached with other large creditors in anticipation of the completion of the Offering, including the Department of Justice, the Company has been able to bring these creditors current and bring the Company into compliance with installment payment agreements providing more favorable terms to the Company. The Offering proceeds also allowed the Company to satisfy its outstanding state and Federal payroll tax obligations and meet current payroll tax obligations. The net proceeds from the exercise of the Option were used to fund working capital, including the purchase of raw materials, payroll expenses and other Company expenses.

Prior to the completion of the Offering, the Company was in negotiations with the DOJ to restructure the payment of the $2,500,000 fine that had been levied under the Plea Agreement in order to address the Company's failure to satisfy the $125,000 quarterly installments provided for under the Plea Agreement. On March 30, 1998, the Company and the DOJ signed a Letter Agreement serving to amend the Plea Agreement relating to the terms of the Company's satisfaction of the fine assessed under the Plea Agreement. Specifically, the Letter Agreement provides that the Company will satisfy the remaining $2,150,000 of the fine through the payment of $25,000 on a monthly basis commencing June 1, 1998, plus interest on such outstanding balance (at the rate calculated pursuant to 28 U.S.C. Section 1961)(currently 5.319%). Such payment schedule would result in the full satisfaction of the DOJ fine in January, 2006. The Letter Agreement also provides certain restrictions on the payment of salary or compensation to any individual in excess of $150,000 without the written consent of the United States District Court for the District of Maryland, subject to certain exceptions. In addition, the Letter Agreement requires the prepayment of the outstanding fine to the extent of 25% of the Company's after tax profit and 25% of the net proceeds received by the Company on any sale of a capital asset for a sum in excess of $10,000.

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 Houba Indiana facility as well as a partial tender offer for the Company's common stock. The Company used the proceeds of these borrowings for working capital. To date, $236,000 has been paid by the Company to Mylan against such indebtedness in the form of product deliveries to Mylan. Pursuant to an agreement reached between the parties, the Company is required to satisfy interest on the outstanding indebtedness on an annual basis while the indebtedness remains outstanding and to satisfy the principal amount of such indebtedness in the form of product deliveries to Mylan until such time as the indebtedness is satisfied in full.

The Company secured bridge financing from Galen and certain investors in the Offering in the aggregate amount of $9,504,111, funded through seven separate bridge loan transactions between the period from August through and including December, 1998, as well as an additional bridge loan in March, 1999 (collectively, the "Bridge Loans"). The Bridge Loans were consolidated on December 2, 1998 pursuant to an Amended, Restated and Consolidated Bridge Loan Agreement, as amended to permit the March, 1999 bridge loan (the "Consolidated Bridge Loan"). The Consolidated Bridge Loan bears interest at 10% per annum, is secured by a first lien on all of the Company's assets and has a maturity date of May 30, 1999. Approximately $9,120,000 in the principal amount of the Consolidated Bridge Loan was advanced by Galen with the balance of approximately $384,000 advanced by certain investors in the Offering. The Consolidated Bridge Loan is evidenced by 10% convertible senior secured promissory notes which are convertible at any time prior to maturity into shares of the Company's Common Stock at a conversion price of approximately $1.368 per share with respect to approximately $7,820,000 of such indebtedness, $1.331 per share with respect to approximately $284,000 of such indebtedness, and $1.197 per share with respect to approximately $1,400,000 of such indebtedness, for an aggregate of 7,099,338 shares of common stock (such conversion prices equal the fair market value of the Common Stock at the date of issuance of the convertible promissory notes). In addition, in consideration for the initial extension of the Bridge Loans and the extension of the maturity dates of the Bridge Loans pursuant to the consolidation of such loans on December 2, 1998, as amended to permit the March, 1999 bridge loan, the Company issued common stock purchase warrants to Galen and the other investors in the Consolidated Bridge Loan, to purchase an aggregate of approximately 1,009,909 shares of the Company's common stock (representing warrants to purchase 50,000 shares of Common Stock for each $1,000,000 in principal amount of Bridge Loan having a term of 90 days from the date of the making of the Bridge Loan). The Bridge Loan warrants are substantially identical to those issued by the Company in its Debenture and Warrant Offering completed on March 10, 1998.

The Consolidated Bridge Loan was obtained by the Company in order to provide necessary working capital. In view of the Company's current cash reserves and projections for revenues through May 30, 1999, the Company will be unable to satisfy the Consolidated Bridge Loan in full at the stated maturity date of May 30, 1999. Galen, the holder of approximately 96% of such indebtedness, has indicated to the Company a willingness to cooperate in the restructuring of the indebtedness evidenced by the Consolidated Bridge Loan to extend the maturity date of such debt and/or convert the debt into common stock or longer-term convertible indebtedness. The terms of such restructuring will depend, to a large extent, on the terms and timing of any third-party investment, as described below. Accordingly, the terms of any such restructuring have yet to be agreed to by the parties and will be subject to the negotiation and preparation of definitive agreements.

The Company is in preliminary discussions with an unaffiliated third party concerning the terms of a proposed investment in the Company in an amount of up to $15 million, to be funded in three equal increments based on the achievement of certain milestones. The structure of the investment will likely take the form of convertible debentures and common stock purchase warrants, similar in many respects to the debentures and warrants issued by the Company in its March 10, 1998 offering. The discussions with this third party investor are in the preliminary stages and no assurance can be given that final terms acceptable to the Company will result and/or that if consummated, that the Company will be successful in achieving the milestones necessary to fund all or any portion of the proposed investment.

In the event the Company is successful in restructuring the Consolidated Bridge Loan and completing a third party investment of the type and size described above, the Company will have sufficient cash reserves to satisfy its working capital requirements for at least the next 12 months. The Company is also seeking to secure a senior revolving line of credit from a banking institution. There can be no assurance, however, that the Company will be able to obtain such third party investment or a bank facility. If the Company is unable to complete the third party investment described above or obtain other sources of working capital, including a bank line of credit or proceeds from the issuance of debt and/or equity securities, the Company's cash reserves will be sufficient to satisfy the Company's working capital requirements for approximately two to three months. Failure to obtain a third party investment of the type described above, a bank line of credit or alternative sources of financing of a comparable amount in the near term will materially adversely affect the Company's working capital position and financial condition and results of operations.

CAPITAL EXPENDITURES

The Company's capital expenditures during 1998, 1997 and 1996 were $1,545,000, $85,000 and $390,000. The increase in capital expenditures in 1998 as compared to prior years is attributable to the implementation of certain equipment and facility upgrades that had been delayed in prior years due to the Company's cash conservation measures in those years.

YEAR 2000 COMPLIANCE

The Company is aware of issues associated with the programming code in existing computer systems as the Year 2000 approaches and has undertaken a compliance program to assess the Company's potential exposure to business interruptions due to the possible Year 2000 computer software failures, including necessary remediation and testing. In 1999, the Company installed a new information system, including hardware and software, which the Company believes, based on its testing, is Year 2000 compliant.

The Company is dependent upon its customers and suppliers in meeting its ongoing business needs. The Company's Year 2000 program includes identifying these third parties and determining, based on both written and verbal communication, that they are either in compliance or expect to be in compliance. Lack of compliance by a third party on whom the Company depends for critical goods or services could have a material adverse effect on the Company's operations in the absence of the third party's ability to meet the Company's needs through a contingency plan or the Company's ability to obtain the goods or services elsewhere.

Currently, the Company believes the largest area of exposure concerning the Year 2000 lies with third party suppliers of raw materials especially those located in foreign countries. The contingency plan to mitigate the disruption among these suppliers includes the buildup of critical raw material inventories. However, the extent to which this may be required has not yet been determined and therefore the cost and ability to accumulate such inventories cannot be estimated at this time.

In the event the Year 2000 issues were to disrupt the Company and its operations, such disruption may have a material impact on the Company and its results of operations. Given that no significant issues have arisen based on the assessments to date, the Company has identified a preliminary contingency plan and is prepared to make necessary corrections to its systems in the event a problem should occur. The Company will continue to assess the Year 2000 compliance issue on an on-going basis in an effort to resolve any Year 2000 issues in a timely manner.

IMPACT OF INFLATION

The Company believes that inflation did not have a material impact on its operations for the periods reported. Significant increases in labor, employee benefits and other expenses could have a material adverse effect on the Company's performance.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The response to this item is submitted as a separate section of this Report commencing on page F-1.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Financial Statements -- See Index to Financial Statements.

(b) Reports on Form 8-K

No reports on Form 8 K were filed during the last quarter of the fiscal year covered by this Annual Report on Form 10-K.

(c) Exhibits

The following exhibits are included as a part of this Annual Report on Form 10-K or incorporated herein by reference.

EXHIBIT NUMBER	DOCUMENT
*3.1	Certificate of Incorporation and amendments.
3.2	Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1993).
*3.3	Restated By-Laws
10.1	Credit Agreement, dated as of December 22, 1992, among the Registrant and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 10.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1992 (the "1992 Form 10-K")).
10.2	Amendment Two, dated as of January 12, 1994, to Credit Agreement among the Registrant and The Chase Manhattan Bank, N.A., together with forms of Stock Warrant and Registration Rights Agreement (incorporated by reference to Exhibit 10.1. to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1993 (the "1993 Form 10-K")).
10.3	Amendment Three, dated as of May 31, 1994, to Credit Agreement among the Registrant and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 6(a) to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1994).
10.4	Amendment Four, dated as of July 1994, to Credit Agreement among the Registrant and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 6(a) to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994).
10.5	Amendment Five, dated as of March 21, 1995, to Credit Agreement among the Registrant and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 10.7 to the Registrant's Current Report on Form 8-K dated March 21, 1995 (the "March 8-K")).
10.5(l)	Form of Warrants issued to The Bank of New York, The Chase Manhattan Bank, N.A. and the Israel Discount Bank (incorporated by reference to Exhibit 10.5(i) to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 (the "1995 Form 10-K")).
10.5(2)	Letter Agreement, dated July 10, 1995, among Halsey Drug Co., Inc., The Chase Manhattan Bank, N.A., The Bank of New York and Israel Discount Bank of New York (incorporated by reference to Exhibit 6(a) to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1995 (the "June 10-Q")).
10.5(3)	Letter Agreement, dated November 16, 1995, among Halsey Drug Co., Inc., The Chase Manhattan Bank, N.A., The Bank of New York and Israel Discount Bank of New York (incorporated by reference to Exhibit 10.25(iv) to the 1995 10-K).
10.5(4)	Amendment 6, dated as of August 6, 1996, to Credit Agreement among Halsey Drug Co., Inc., The Chase Manhattan Bank, N.A., The Bank of New York and Israel Discount Bank of New York (incorporated by reference to Exhibit 10.1 to Amendment No. 1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996 (the "June 1996 10-Q").
10.5(5)	Letter Agreement, dated March 25, 1997 among Halsey Drug Co., Inc., The Chase Manhattan Bank, as successor in interest to The Chase Manhattan Bank (National Association), The Bank of New York and Israel Discount Bank.
10.6	Agreement Regarding Release of Security Interests dated as of March 21, 1995 by and among the Company, Mallinckrodt Chemical Acquisition, Inc. and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 10.9 of the March 8-K).
10.7	Consulting Agreement dated as of September, 1993 between the Registrant and Joseph F. Limongelli (incorporated by reference to Exhibit 10.6 to the 1993 Form 10-K).
10.8	Employment Agreement, dated as of January 1, 1993, between the Registrant and Rosendo Ferran (incorporated by reference to Exhibit 10.2 to the 1992 Form 10-K).
10.10(1)	Halsey Drug Co., Inc. 1984 Stock Option Plan, as amended (incorporated by reference to Exhibit 10.3 to the 1992 Form 10-K).
10.10(2)	Halsey Drug Co., Inc. 1995 Stock Option and Restricted Stock Purchase Plan (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8, File

No. 33-98396).

EXHIBIT NUMBER	DOCUMENT
10.10(3)	Halsey Drug Co., Inc. Non-Employee Director Stock Option Plan.
10.11	Leases, effective February 13, 1989 and January 1, 1990, respectively, among the Registrant and Milton J. Ackerman, Sue Ackerman, Lee Hinderstein, Thelma Hinderstein and Marilyn Weiss (incorporated by reference to Exhibits 10.6 and 10.7, respectively, to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1989).
10.12	Lease, effective as of April 15, 1988, among the Registrant and Milton J. Ackerman, Sue Ackerman, Lee Hinderstein, Thelma Hinderstein and Marilyn Weiss, and Rider thereto (incorporated by reference to Exhibit 10.12 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1987).
10.12(l)	Lease, as of October 31, 1994, among Registrant and Milton J. Ackerman, Sue Ackerman, Lee Hinderstein, Thelma Hinderstein and Marilyn Weiss, together with Modification, Consolidation and Extension Agreement (incorporated by reference to Exhibit 10. 12(i) to the 1995 Form 10-K).
10.13	Asset Purchase Agreement dated as of March 21, 1995 among Mallinckrodt Chemical Acquisition, Inc. ("Acquisition"), Mallinckrodt Chemical, Inc., as guarantor and the Registrant (incorporated by reference to Exhibit 10.1 to the March 8-K).
10.14	Toll Manufacturing Agreement for APAP/Oxycodone Tablets dated as of March 21, 1995 between Acquisition and the Registrant (incorporated by reference to Exhibit 10.2 to the March 8-K).
10.15	Capsule ANDA Option Agreement dated as of March 21, 1995 between Acquisition and the Registrant (incorporated by reference to Exhibit 10.3 to the March 8-K).
10.16	Tablet ANDA Noncompetition Agreement dated as of March 21, 1995 between the Registrant and Acquisition (incorporated by reference to Exhibit 10.4 to the March 8-K).
10.17	Subordinated Non-Negotiable Promissory Term Note in the amount of $1,200,00 dated March 21, 1995 issued by the Registrant to Acquisition (incorporated by reference to Exhibit 10.5 to the March 8-K).
10.18	Term Note Security Agreement dated as of March 21, 1995 among the Company, Houba, Inc. and Acquisition (incorporated by reference to Exhibit 10.6 to the March 8-K).
10.19	Amendment dated March 21, 1995 to Subordination Agreement dated as of July 21, 1994 between Mallinckrodt Chemical, Inc., Mallinckrodt Chemical Acquisition, Inc., the Registrant, The Chase Manhattan Bank (National Association), Israel Discount Bank of New York, The Bank of New York, and The Chase Manhattan Bank (National Association) (incorporated by reference to Exhibit 10.8 to the March 8-K).
10.20	Agreement dated as of March 30, 1995 between the Registrant and Zatpack, Inc. (incorporated by reference to Exhibit 10.10 to the March 8-K).
10.21	Waiver and Termination Agreement dated as of March 30, 1995 between Zuellig Group, W.A., Inc. and Indiana Fine Chemicals Corporation (incorporated by reference to Exhibit 10.11 to the March 8-K).
10.22	Convertible Subordinated Note of the Registrant dated December 1, 1994 issued to Zatpack, Inc. (incorporated by reference to Exhibit 10.12 to the March 8-K).
10.23	Agreement dated as of March 30, 1995 among the Registrant, Indiana Fine Chemicals Corporation, Zuellig Group, N.A., Inc., Houba Inc., Zetapharm, Inc. and Zuellig Botanical, Inc. (incorporated by reference to Exhibit 10.13 to the March 8-K).
10.24	Supply Agreement dated as of March 30, 1995 between Houba, Inc. and ZetaPharm, Inc. (incorporated by reference to Exhibit 10.14 to the March 8-K).
10.25	Form of 10% Convertible Subordinated Debenture (incorporated by reference to Exhibit 6(a) to the June 10-Q).
10.26	Form of Redeemable Common Stock Purchase Warrant (incorporated by reference to Exhibit 6(a) to the June 10-Q).
10.27	Form of 10% Convertible Subordinated Debenture (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated December 4, 1995 (the "December 8-K")).

10.28 Form of Redeemable Common Stock Purchase Warrant (incorporated by reference to Exhibit 4.2 to the December 8-K).

EXHIBIT NUMBER	DOCUMENT
10.29	Form of 10% Convertible Subordinated Debenture (incorporated by reference to Exhibit 99 to the June 1996 10-Q).
10.30	Form of Redeemable Common Stock Purchase Warrant (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the June 1996 10-Q).
10.31	Form of 5% Convertible Senior Secured Debenture (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K dated March 24, 1998 (the "March 1998 8-K")).
10.32	Form of Common Stock Purchase Warrant (incorporated by reference to Exhibit 4.2 to the March 1998 8-K).
10.33	Debenture and Warrant Purchase Agreement dated March 10, 1998, by and among the Registrant, Galen Partners III, L.P. and the other Purchasers listed on the Signature Page thereto (incorporated by reference to Exhibit 10.1 to the March 1998 8-K).
10.34	Form of General Security Agreement of Halsey Drug Co., Inc. dated March 10, 1998 (incorporated by reference to Exhibit 10.2 to the March 1998 8-K).
10.35	Form of Agreement of Guaranty of Subsidiaries of Halsey Drug Co., Inc. dated March 10, 1998 (incorporated by reference to Exhibit 10.3 to the March 1998 8-K).
10.36	Form of Guarantor General Security Agreement dated March 10, 1998 (incorporated by reference to Exhibit 10.4 to the March 1998 8-K).
10.37	Stock Pledge Agreement dated March 10, 1998 by and between the Registrant and Galen Partners III, L.P., as agent (incorporated by reference to Exhibit 10.5 to the March 1998 8-K).
10.38	Form of Irrevocable Proxy Agreement (incorporated by reference to Exhibit 10.6 to the March 1998 8-K).
10.39	Agency Letter Agreement dated March 10, 1998 by and among the Purchasers a party to the Debenture and Warrant Purchase Agreement, dated March 10, 1998 (incorporated by reference to Exhibit 10.7 to the March 1998 8-K).
10.40	Press Release of Registrant dated March 13, 1998 (incorporated by reference to Exhibit 99.1 to the March 1998 8-K).
10.41	Current Report on Form 8-K as filed by the Registrant with the Securities and Exchange Commission on March 24, 1998.
10.42	Letter Agreement between the Registrant and the U.S. Department of Justice dated March 27, 1998 relating to the restructuring of the fine assessed by the Department of Justice under the Plea Agreement dated June 21, 1993.
10.43	Employment Agreement dated as of March 10, 1998 between the Registrant and Michael K. Reicher.
10.44	Employment Agreement dated as of March 10, 1998 between the Registrant and Peter Clemens.
*10.45	Amended, Restated and Consolidated Bridge Loan Agreement dated as of December 2, 1998 between the Company, Galen Partners III, L.P., Galen Partners International III, L.P., Galen Employee Fund III, L.P. and the other signatures thereto.
*10.46	First Amendment to Amended, Restated and Consolidated Bridge Loan Agreement dated December 7, 1998 between the Company and the lenders listed on the signature page thereto.
*10.47	Second Amendment to Amended, Restated and Consolidated Bridge Loan Agreement dated March 8, 1999 between the Company and the lenders listed on the signature page thereto.
*10.48	Form of 10% Convertible Secured Note due May 30, 1999.
*10.49	Form of Common Stock Purchase Warrant issued pursuant to be Amended, Restated and Consolidated Bridge Loan Agreement.
*10.50	Amended and Restated General Security Agreement dated December 2, 1998 between the Company and Galen Partners III, L.P., as Agent.
*10.51	Subordination Agreement dated December 2, 1998 between the Registrant and Galen Partners III, L.P., as Agent.
*10.52	Agency Letter Agreement dated December 2, 1998 by and among the lenders a party to the Amended, Restated and Consolidated Bridge Loan Agreement, as amended.

EXHIBIT NUMBER	DOCUMENT
*10.53	Lease Agreement dated March 17, 1999 between the Registrant and Par Pharmaceuticals, Inc.
*10.54	Lease Agreement dated September 1, 1998 between the Registrant and Crimson Ridge Partners.
*10.55	Manufacturing and Supply Agreement dated March 17, 1999 between the Registrant and Par Pharmaceuticals, Inc.
*10.56	Halsey Drug Co., Inc. 1998 Stock Option Plan.
21	Subsidiaries of the Registrant (incorporated by reference to Exhibit 22 to the 1993 Form 10-K).
*23.1	Consent of Grant Thornton LLP, independent certified public accountants.
*27	Financial Data Schedule, which is submitted electronically to the Securities and Exchange Commission for informational purposes only and not filed.

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* Filed herewith.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Halsey Drug Co., Inc.

We have audited the accompanying consolidated balance sheets of Halsey Drug Co., Inc. and Subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Halsey Drug Co., Inc. and Subsidiaries as of December 31, 1998 and 1997, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

GRANT THORNTON LLP

New York, New York
March 5, 1999

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 1998	DECEMBER 31, 1997
	(IN THOUSANDS)	
CURRENT ASSETS		
Cash	$ 1,850	$ 26
Accounts receivable -- trade, net of allowances for doubtful accounts of $280 and $542 in 1998 and 1997, respectively	1,439	62
Inventories	6,354	2,456
Prepaid insurance and other current assets	148	274
Total current assets	9,791	2,818
PROPERTY, PLANT AND EQUIPMENT, NET	4,787	4,630
DEFERRED PRIVATE OFFERING COSTS	1,335	219
	$ 15,913	$ 7,667
CURRENT LIABILITIES		
Convertible bridge loans	$ 7,533	$ --
Notes payable	2,817	4,825
Bank overdraft		159
Due to banks		2,476
Convertible subordinated debentures		2,244
Accounts payable	1,834	6,086
Accrued expenses	3,972	7,232
Deferred gain		1,900
Other current liabilities	300	200
Total current liabilities	16,456	25,122
LONG-TERM DEBT, NET	26,186	
OTHER LIABILITIES	2,224	2,402
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock -- $.01 par value; authorized, 40,000,000 shares; issued 14,443,212 shares and 14,029,718 shares in 1998 and 1997, respectively	144	140
Additional paid-in capital	29,113	25,489
Accumulated deficit	(57,221)	(44,497)
	(27,964)	(18,868)
Less treasury stock -- at cost (439,603 shares in 1998 and 1997, respectively)	(989)	(989)
	(28,953)	(19,857)
	$ 15,913	$ 7,667

The accompanying notes are an integral part of these statements.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
	(IN THOUSANDS, EXCEPT PER SHARE DATA)		
Net sales	$ 8,841	$ 9,088	$ 12,379
Cost of goods sold	12,712	15,406	16,826
Gross margin	(3,871)	(6,318)	(4,447)
Research and development	651	979	1,854
Selling, general and administrative expenses	8,078	6,308	7,486
Loss from operations	(12,600)	(13,605)	(13,787)
Interest expense	(1,946)	(1,144)	(1,708)
Other income (expense)	1,802	(264)	1,000
NET LOSS	$(12,724)	$(15,013)	$(14,495)
Basic loss per common share	$ (.92)	$ (1.12)	$ (1.49)
Weighted average number of outstanding shares	13,813	13,434	9,724

The accompanying notes are an integral part of these statements.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

	COMMON STOCK, $.01 PAR VALUE		ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	TREASURY STOCK, AT COST		TOTAL
	SHARES	AMOUNT			SHARES	AMOUNT	
				(IN THOUSANDS)			
Balance at January 1, 1995	8,974	$ 90	$14,459	$(14,989)	(500)	$(1,100)	$ (1,540)
Issuance of common stock conversion of debentures	3,504	35	6,724				6,759
Issuance of shares as settlement	60		262		25	56	318
Issuance of warrants with convertible subordinated debentures			355				355
Exercise of warrants of convertible debentures	589	6	1,363				1,369
Stock options exercised	49		153				153
Net loss for the year ended December 31, 1996				(14,495)			(14,495)
Balance at December 31, 1996	13,176	131	23,316	(29,484)	(475)	(1,044)	(7,081)
Issuance of common stock -- conversion of debentures	643	7	1,529				1,536
Issuance of shares as payment of interest	69	1	224				225
Sale of treasury stock	25		45		35	55	100
Exercise of warrants of convertible debentures	22		72				72
Stock options exercised	95	1	303				304
Net loss for the year ended December 31, 1997				(15,013)			(15,013)
Balance at December 31, 1997	14,030	140	25,489	(44,497)	(440)	(989)	(19,857)
Issuance of common stock -- conversion of notes payable	110	1	213				214
Issuance of shares as payment of interest	263	3	592				595
Issuance of common stock -- settlement of trade payables	40		55				55
Deferred debt discount on warrants issued with convertible debentures			2,264				2,264
Net loss for the year ended December 31, 1998				(12,724)			(12,724)
Balance at December 31, 1998	14,443	$144	$28,613	$(57,221)	(440)	$ (989)	$(29,453)

The accompanying notes are an integral part of this statement.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
	(IN THOUSANDS)		
Cash flows from operating activities			
Net loss	$(12,724)	$(15,013)	$(14,495)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation and amortization	1,774	1,733	1,906
Provision for losses on accounts receivable	(262)	118	144
Provision for loss on investment			500
(Gain) loss on disposal of assets	170	38	(1,000)
Changes in assets and liabilities			
Accounts receivable	(1,115)	45	1,319
Inventories	(3,898)	1,302	3,958
Prepaid insurance and other current assets	126	165	(96)
Accounts payable	(4,197)	1,851	1,029
Deferred gain	(1,900)		
Accrued expenses	(2,665)	4,553	2,913
Total adjustments	(11,967)	9,805	10,673
Net cash used in operating activities	(24,691)	(5,208)	(3,822)
Cash flows from investing activities			
Capital expenditures	(1,545)	(85)	(390)
Net proceeds from sale of assets	96		
Collection of notes receivable		1,000	
Net cash (used in) provided by investing activities	(1,449)	915	(390)
Cash flows from financing activities			
Proceeds from issuance of notes payable	$ 6,495	$ 3,881	$ 25
Proceeds from issuance of common stock			318
Reissuance of treasury stock		70	
Payments to Department of Justice	(178)		
Bank overdraft	(159)	(127)	73
Due to banks	(2,476)		
Payments to minority stockholders			(206)
Proceeds from issuance of convertible subordinated debentures	25,800		2,500
Proceeds from exercise of stock options and warrants		305	153
Proceeds from exercise of warrants		72	1,369
Deferred private offering costs	(1,518)		(255)
Net cash provided by financing activities	27,964	4,201	3,977
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	1,824	(92)	(235)
Cash and cash equivalents at beginning of year	26	118	353
Cash and cash equivalents at end of year	$ 1,850	$ 26	$ 118

HALSEY DRUG CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS -- (CONTINUED)
YEAR ENDED DECEMBER 31,
(IN THOUSANDS)

Supplemental disclosures of noncash activities:

Year ended December 31, 1998

1. The Company issued 262,836 shares of common stock as payment for $593,313 in accrued interest.

2. The Company reissued 20,000 shares of common stock as payment for $25,000 in legal fees and 20,000 shares of common stock as payment for $30,000 in trade payables.

3. The Company issued 110,658 shares of common stock as payment of outstanding notes payable in amounts of $214,000 and $1,782 in accrued interest.

4. The Company issued approximately 4,202,020 warrants (Note A) and 1,009,909 warrants (Note A) valued and recorded in aggregate as $3,118,000 of unamortized debt discount and a reduction in the related amount of the obligation.

Year ended December 31, 1997

1. The Company issued 642,407 shares of common stock to Zatpack, Inc. as payment for an outstanding note payable in the amount of $1,536,000.

2. The Company reissued 25,000 shares of treasury stock as payment for $30,000 in consulting fees and the receipt of $70,000 in cash.

3. The Company issued 25,000 shares of common stock as payment for $225,452 in accrued interest.

4. The Company recorded the satisfaction of $1,400,000 of subordinated promissory notes, related accrued interest of $200,000 and accounts payable of $300,000 due to Mallinckrodt, in lieu of Mallinckrodt paying $1,900,000 owed to the Company as described in Note E.

Year ended December 31, 1996

1. The issuance of 3,504,000 shares of the Company's common stock upon conversion of $6,759,000 of convertible subordinated debentures is included in common stock and additional paid-in capital.

2. The valuation of the warrants issued in 1996 of $355,000 with convertible subordinated debentures is included in additional paid-in capital.

3. The issuance in 1996 of 59,550 shares of the Company's common stock is valued at $318,000 in connection with litigation settlements.

The accompanying notes are an integral part of these statements.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1998, 1997 AND 1996

NOTE A -- SUMMARY OF ACCOUNTING POLICIES

Halsey Drug Co., Inc. (the "Company"), a New York-based corporation established in 1935, and its subsidiaries are engaged in the manufacture, sale and distribution of generic drugs. The Company sells its generic drug products under its Halsey label and under private-label arrangements with drug store chains and drug wholesalers throughout the United States.

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

1. Principles of Consolidation and Basis of Presentation

The consolidated financial statements include 100% of the accounts of the Company and its wholly-owned subsidiaries, Blue Cross Products Co., Inc., Houba, Inc., Halsey Pharmaceuticals, Inc., and Indiana Fine Chemicals Corporation, The Medi-Gum Corporation (100% owned). The Medi-Gum Corporation and Halsey Pharmaceuticals have not commenced operations. All material intercompany accounts and transactions have been eliminated.

2. Liquidity Matters

As of December 31, 1998, the Company has a working capital deficiency of approximately $6,665,000, has an accumulated deficit of approximately $57,221,000 and has incurred a loss of approximately $12,724,000 for the year then ended.

On March 10, 1998, the Company completed a private offering (the "Offering") of securities to an investor group ("Galen") consisting of 5% convertible senior secured debentures due March 15, 2003, and common stock purchase warrants (with a 5 year life) exercisable for 2,101,010 shares of the Company's common stock at an exercise price of $1.50 and 2,101,010 shares at an exercise price of $2.375. The unamortized discount resulting from the issuance of such warrants ($2,618,000) has been recorded as a reduction of the related obligation. The net proceeds to the Company from the Offering, after the deduction of related offering expenses of $1,518,000 for legal fees and investment banker fees, was approximately $19.3 million. These related offering costs will be amortized over the remaining five (5) year life of the related debentures. In addition, in accordance with the terms of the private offering, during June 1998, Galen invested an additional $5 million in the Company in exchange for debentures and warrants having terms identical to those issued in the Offering.

The net proceeds from the Offering and the additional investment have primarily been used to satisfy a substantial portion of the Company's liabilities and accounts payable. Such liabilities include the full satisfaction of the Company's bank indebtedness and related fees, payment to the landlord of the Brooklyn facility and satisfaction of outstanding judgments and liens. Further, pursuant to agreements reached with other large creditors in anticipation of the completion of the offering, including the Company's landlord and the Department of Justice ("DOJ"), the Company has been able to bring these creditors current and bring the Company in compliance with installment payment agreements providing more favorable terms to the Company. The offering proceeds also allowed the Company to satisfy its outstanding state and Federal payroll tax obligations and meet current payroll tax obligations. The net proceeds from the exercise of the option were used to fund working capital, including the purchase of raw materials, payroll expenses and other Company expenses.

The Company secured bridge financing from Galen and certain investors in the Offering in the aggregate amount of $9,504,111, funded through seven separate bridge loan transactions between the period from August through and including December 1998, as well as an additional bridge loan in March 1999 (collectively, the "Bridge Loans"). The Bridge Loans were consolidated on December 2, 1998 pursuant to an

Amended, Restated and Consolidated Bridge Loan Agreement, as amended to permit the March 1999 bridge loan (the "Consolidated Bridge Loan"). The Consolidated Bridge Loan bears interest at 10% per annum, is secured by a first lien on all of the Company's assets and has a maturity date of May 30, 1999. Approximately $9,120,000 in the principal amount of the Consolidated Bridge Loan was advanced by Galen with the balance of approximately $384,000 advanced by certain investors in the Offering. The Consolidated Bridge Loan is evidenced by 10% convertible senior secured promissory notes which are convertible at any time prior to maturity into shares of the Company's Common Stock at a conversion price of approximately $1.368 per share with respect to approximately $7,820,000 of such indebtedness, $1.331 per share with respect to approximately $284,000 of such indebtedness, and $1.197 per share with respect to approximately $1,400,000 of such indebtedness, for an aggregate of 7,099,338 shares of common stock (such conversion prices equal the fair market value of the Common Stock at the date of issuance of the convertible promissory notes). In addition, in consideration for the initial extension of the Bridge Loans and the extension of the maturity dates of the Bridge Loans pursuant to the consolidation of such loans on December 2, 1998, as amended to permit the March 1999 bridge loan, the Company issued common stock purchase warrants to Galen and the other investors in the Consolidated Bridge Loan, to purchase an aggregate of approximately 1,009,909 shares of the Company's common stock (representing warrants to purchase 50,000 shares of Common Stock for each $1,000,000 in principal amount of Bridge Loan having a term of 90 days from the date of the making of the Bridge Loan). The unamortized discount resulting form the issuance of such warrants ($500,000) has been recorded as a reduction of the related obligation. The Bridge Loan warrants are substantially identical to those issued by the Company in its Debenture and Warrant Offering completed on March 10, 1998.

The Consolidated Bridge Loan was obtained by the Company in order to provide necessary working capital. In view of the Company's current cash reserves and projections for revenues through May 30, 1999, the Company will be unable to satisfy the Consolidated Bridge Loan in full at the stated maturity date of May 30, 1999. Galen, the holder of approximately 96% of such indebtedness, has indicated to the Company a willingness to cooperate in the restructuring of the indebtedness evidenced by the Consolidated Bridge Loan to extend the maturity date of such debt and/or convert the debt into common stock or longer-term convertible indebtedness. The terms of such restructuring will depend, to a large extent, on the terms and timing of any third-party investment, as described below. Accordingly, the terms of any such restructuring have yet to be agreed to by the parties and will be subject to the negotiation and preparation of definitive agreements.

The Company is in preliminary discussions with an unaffiliated third party concerning the terms of a proposed investment in the Company in an amount of up to $15 million, to be funded in three equal increments based on the achievement of certain milestones. The structure of the investment will likely take the form of convertible debentures and common stock purchase warrants, similar in many respects to the debentures and warrants issued by the Company in its March 10, 1998 offering. The discussions with this third-party investor are in the preliminary stages and no assurance can be given that final terms acceptable to the Company will result and/or that if consummated, that the Company will be successful in achieving the milestones necessary to fund all or any portion of the proposed investment.

In the event the Company is successful in restructuring the Consolidated Bridge Loan and completing the third-party investment of the type and size described above, the Company will have sufficient cash reserves to satisfy its working capital requirements for at least the next twelve months. The Company is also seeking to secure a senior revolving line of credit from a banking institution. There can be no assurance, however, that the Company will be able to obtain such third-party investment or a bank facility. If the Company is unable to complete the third-party investment described above or obtain other sources of working capital, including a bank line of credit or proceeds from the issuance of debt and/or equity securities, the Company's cash reserves will be sufficient to satisfy the Company's working capital requirements for approximately two to three months. Failure to obtain a third-party investment of the type described above, a bank line of credit or alternative sources of financing of a comparable amount in the near term will materially adversely affect the Company's working capital position and financial condition and results of operations.

3. Inventories

Inventories are stated at the lower of cost or market; cost is determined using the first-in, first-out method.

4. Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, principally on a straight-line basis. The estimated lives used in determining depreciation and amortization are:

Buildings	25 years
Machinery and equipment	5-10 years
Leasehold improvements	5-10 years

Leasehold improvements are amortized over the lives of the respective leases or the service lives of the improvements, whichever is shorter.

5. Revenue Recognition

Revenues are recognized when products are shipped to customers. Provisions are recorded for uncollectable accounts receivable.

6. Income Taxes

The Company accounts for income taxes utilizing an asset liability method for financial accounting and reporting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

7. Statements of Cash Flows

For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. The Company paid no substantial income taxes for the years ended December 31, 1998, 1997 and 1996. In addition, the Company paid interest of approximately $1,946,000, $1,113,000, $1,173,000, respectively, for the years ended December 31, 1998, 1997 and 1996.

8. Use of Estimates in Consolidated Financial Statements

In preparing consolidated financial statements in conformity with generally accepted accounting principles, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

9. Research and Development Costs

All research and development costs, including payments related to licensing agreements on products under development and research consulting agreements are expensed when incurred.

10. Impairment of Long-Lived Assets

The Company reviews long-lived assets and certain identifiable intangibles held and used for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable (Note I).

11. Stock-Based Compensation

The Company accounts for stock-based compensation under Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," and continues to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its plans and does not recognize compensation expense for its stock-based compensation plans other than for restricted stock (Note K).

Equity instruments issued to nonemployees in exchange for goods and/or services are accounted for under the fair value method of SFAS No. 123.

12. New Pronouncements

Earnings (Loss) Per Share

In 1997, the Company adopted Statement of Financial Accounting Standards No. 128 ("SFAS No. 128"), "Earnings Per Share," which requires public companies to present basic earnings (loss) per share and, if applicable, diluted earnings per share. All comparative periods have been restated in accordance with SFAS No. 128.

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 equal to basic earnings per share for all years presented as the effect of other potentially dilutive securities would be antidilutive.

Reporting Comprehensive Income

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 130 ("SFAS No. 130"), "Reporting Comprehensive Income," which is effective for the Company's year ended December 31, 1998. The statement addresses the reporting and displaying of comprehensive income and its components. Earnings per share is only reported for net income and not for comprehensive income and its components. At December 31, 1998, 1997 and 1996, the Company had no items of other comprehensive income.

13. Reclassifications

Certain reclassifications have been made to the 1997 and 1996 presentations to conform to the 1998 presentation.

NOTE B -- FAIR VALUE OF FINANCIAL INSTRUMENTS

Long-term and Short-term Debt and Convertible Subordinated Debentures

The fair value of the Company's long-term and short-term debt and convertible subordinated debentures is estimated based upon the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same outstanding maturities. Accordingly, the carrying amount of these financial instruments approximates their fair value at December 31, 1998 and 1997.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

NOTE C -- INVENTORIES

Inventories consist of the following:

	DECEMBER 31, 1998	DECEMBER 31, 1997
	(IN THOUSANDS)	
Finished goods	$2,675	$ 789
Work-in-process	1,166	263
Raw materials	2,513	1,404
	$6,354	$2,456

NOTE D -- PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are summarized as follows:

	DECEMBER 31, 1998	DECEMBER 31, 1997
	(IN THOUSANDS)	
Machinery and equipment	$12,278	$11,478
Leasehold improvements	6,103	5,967
Building	747	997
Land	44	265
	19,172	18,707
Less accumulated depreciation and amortization	14,385	14,077
	$ 4,787	$ 4,630

Depreciation expense for the years ended December 31, 1998, 1997 and 1996 was approximately $1,122,000, $1,640,000, and $1,562,000, respectively.

NOTE E -- DEBT

Due to Banks

At December 31, 1997 the Company had $2,476,000 under a line of credit agreement with three participating banks for which the average borrowing rate for the year then ended was 11.9 %. The agreement contained certain financial covenants, for which the Company was not in compliance at December 31, 1997. During March 1998, the Company completely satisfied its bank indebtedness and terminated the line of credit agreement with its banks.

Notes Payable

At December 31, 1998 and 1997, notes payable consisted of the following:

	DECEMBER 31, 1998	DECEMBER 31, 1997
	(IN THOUSANDS)	
Unsecured promissory demand notes	$ 2,817	
Subordinated promissory notes		$4,825
Bridge Loans (Note A)	7,533	
	$10,350	$4,825

During 1997, the Company borrowed from and issued to several debenture holders and shareholders unsecured, demand promissory notes in the amount of $1,125,000, bearing interest at 12% per annum, with interest payable quarterly. These notes were paid in full in 1998.

During the period from May 1997 through July 1997, the Company borrowed approximately $3 million from Mylan Laboratories, Inc. ("Mylan") pursuant to five unsecured, demand promissory notes. The advances made by Mylan Laboratories, Inc. were part of a proposed investment by Mylan in the Company, including the proposed purchase of the Company's Houba Indiana facility as well as a partial tender offer for the Company's common stock. The Company used the proceeds of these borrowings for working capital. To date, $236,000 has been paid by the Company to Mylan against such indebtedness in the form of product deliveries to Mylan. Pursuant to an agreement reached between the parties, the Company is required to satisfy interest on the outstanding indebtedness on an annual basis while the indebtedness remains outstanding and to satisfy the principal amount of such indebtedness in the form of product deliveries to Mylan until such time as the indebtedness is satisfied in full. In 1998, the Company, in exchange for extending the loan, agreed to grant a warrant to purchase 50,000 shares of the Company's common stock at a price of $1.94 per share. The estimated fair value of these warrants (using the Black Scholes Pricing Model) was approximately $56,000 and will be amortized as a charge to operations over the extension period of the loan. Additionally, the Company began reducing the loan by supplying product to Mylan. At December 31, 1998, the loan balance was $2,817,000.

During the fourth quarter of 1997, the Company received $500,000 from an investor of a proposed joint venture, a demand promissory note bearing interest at 10% per annum which was secured by the property of Houba. In addition, as part of a proposed financing agreement, the Company received $200,000 as a promissory note bearing interest at 8% per annum during the fourth quarter of 1997. Both of these promissory notes were paid in full in 1998.

NOTE F -- CONVERTIBLE SUBORDINATED DEBENTURES AND STOCK WARRANTS

In connection with certain 1995 amendments to the line of credit agreement described in Note E, the Company issued stock warrants to the bank, expiring July 17, 2000, to purchase up to 699,696 shares of the Company's common stock at exercise prices ranging from $1.98 to $2.07 per share. The fair value of the warrants, $200,000, as determined by the Company's Board of Directors, was recorded by the Company in 1994 as additional paid-in capital and a discount to bank debt which was fully amortized through the maturity date, August 31, 1995.

On July 18, 1995, the Company issued 408 units, at $10,000 per unit, in a private placement of its securities ("July Private Placement"). Each unit consisted of: (i) a 10% convertible subordinated debenture due July 18, 2000 in the principal amount of $10,000, interest payable quarterly, and convertible into shares of the Company's common stock at a conversion price of $2.00 per share, subject to antidilution provisions, and (ii) 750 redeemable common stock purchase warrants ("warrants"). Each warrant entitled the holder to purchase one share of common stock for $2.00, subject to adjustment during the five-year period commencing July 18, 1995. The warrants were redeemable by the Company at a price of $.01 per warrant at any time commencing July 18, 1996, provided that at July 18, 1996, the fair market value of the Company's common stock equals or exceeds $2.00 per share for the 20 consecutive trading days ending on the third day prior to the notice of redemption to the holders of the warrant. The debentures were converted into 2,040,000 shares of common stock in August 1996.

On November 29, 1995, the Company issued 366 units, at $10,000 per unit, in a private placement of its securities ("November Private Placement"). Each unit consisted of (i) a 10% convertible subordinated debenture due November 29, 2000 in the principal amount of $10,000, interest payable quarterly, and convertible into shares of the common stock, at a conversion price of $2.50 per share, subject to dilution, and (ii) 600 redeemable common stock purchase warrants. The terms and conditions of the warrants issued in

connection with the November Private Placement are similar to those issued in the July Private Placement, except that the exercise price of the warrant pursuant to the November Private Placement is $2.50 per share. These debentures were converted into 1,464,000 shares of common stock in December 1996.

On August 6, 1996, the Company issued 250 units, at $10,000 per unit, in a private placement of its securities ("August Private Placement"). Each unit consisted of: (i) a 10% convertible subordinated debenture due August 6, 2001 in the principal amount of $10,000, interest payable quarterly, and convertible into shares of the Company's common stock at a conversion price of $3.25 per share, subject to dilution, and (ii) 750 redeemable common stock purchase warrants ("warrants"). Each warrant entitled the holder to purchase one share of common stock for $3.25, subject to adjustment during the five-year period commencing August 6, 1996. Pursuant to the agreement, the Company was required to establish an escrow account to repay interest in the outstanding convertible debenture, which was fully paid during 1997.

NOTE G -- ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	DECEMBER 31,	
	1998	1997
	(IN THOUSANDS)	
Payroll taxes payable (Note H)	$1,714	$3,290
Interest	619	1,018
Professional fees	539	537
Accrued pension and welfare	15	501
Medicaid rebates payable	169	481
Accrued payroll	92	420
Directors' fees	126	90
New York State Department of Education	140	134
Medical claims	149	
Commissions	30	42
Property taxes	94	
Accrued chargeback liability	40	
Accrued equipment purchase	56	
Other	189	719
	$3,972	$7,232

At December 31, 1998, payroll taxes payable include approximately $1,373,000 and $275,000 of delinquent payroll taxes (including penalties and interest) due to the Internal Revenue Service and the State of New York, respectively, all of which liability was incurred in 1997 and 1996. The Company expects that the Federal liability will be substantially offset by income tax refund claims which were filed and are pending before the IRS. Until such time as the IRS completes its review, the Company has not recorded any expected tax refund claims. The Company has negotiated a payment plan with the State of New York and the balance will be paid by the end of 1999.

NOTE H -- INCOME TAXES

The actual income tax expense varies from the Federal statutory rate applied to consolidated operations as follows:

	YEAR ENDED DECEMBER 31,					
	1998		1997		1996	
	AMOUNT	%	AMOUNT	%	AMOUNT	%
	(IN THOUSANDS)					
Federal statutory rate	$(4,326)	(34.0)%	$(5,105)	(34.0)%	$(4,928)	(34.0)%
Loss for which no tax benefit was provided	4,247	33.8	4,924	32.8	4,233	29.1
Losses of subsidiaries with no tax benefit					424	3.0
Amortization of Warrants			24	.2	32	.2
Goodwill amortization			12	.1	73	.5
Department of Justice settlement	42	.1			57	.4
Other	37	.1	145	.9	109	.8
Actual tax expense	$ --	--%	$ --	--%	$ --	--%

The Company has net operating loss carryforwards aggregating approximately $45,572,700, expiring during the years 2011 through 2018. In addition, certain of the Company's subsidiaries filed separate Federal income tax returns in prior years and have separate net operating loss carryforwards aggregating approximately $4,062,758 expiring during the years 1999 through 2018.

The tax loss carryforwards of the Company and its subsidiaries are subject to limitation by Section 382 of the Internal Revenue Code with respect to the amount utilizable each year. This limitation reduces the Company's ability to utilize net operating loss carryforwards included above each year. The amount of the limitation has not been quantified by the Company.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The components of the Company's deferred tax assets (liabilities), pursuant to SFAS No. 109, are summarized as follows:

	DECEMBER 31, 1998	DECEMBER 31, 1997
	(IN THOUSANDS)	
Deferred tax assets		
Net operating loss carryforwards	$ 21,831	$ 15,125
Allowance for doubtful accounts	75	304
Research and development tax credit	212	212
Reserve for inventory	169	886
Litigation settlement	73	195
Rent	231	172
Reserve for Medicaid	71	209
Capital loss carryforwards		210
Reserve for property, plant and equipment		111
Other	15	24
Gross deferred tax assets	22,677	17,448
Deferred tax liabilities		
Depreciation	(332)	(828)
Installment sale gain		(798)
Other	(42)	(42)
	(374)	(1,668)
Net deferred tax assets before valuation allowance	22,303	15,780
Valuation allowance	(22,303)	(15,780)
Net deferred tax assets	$ --	$ --

SFAS No. 109 requires a valuation allowance against deferred tax assets if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets may not be realized. The valuation allowance at December 31, 1998 primarily pertains to uncertainties with respect to future utilization of net operating loss carryforwards.

NOTE I -- OTHER INCOME (EXPENSE)

Cessation of California Operations

During 1997, management decided to shut down its California operations which comprised two of its subsidiaries, Cenci Powder Products, Inc. and H.R. Cenci Laboratories, Inc. The Company had not incurred any significant costs to exit these operations other than minimal vacation compensation and salary paid to a former plant employee to manage the exit process. Continuing operating losses and the inability to leverage the manufacturing capacity were among factors considered by the Board and Management in their determination to cease such operations.

At December 31, 1997, the net assets of H.R. Cenci Laboratories, Inc., consisted primarily of building, equipment and land with a net carrying value of $528,000 and inventory with a total net carrying value of $93,000. Accordingly, during 1997 the Company recorded a charge of $264,000 to reduce the fixed assets to their then estimated net realizable value, and a $93,000 charge to write off the remaining inventory. In 1998, the Company disposed of the remaining assets and recorded a charge of $191,000. For the years ended

December 31, 1998, 1997 and 1996, these subsidiaries, in aggregate, accounted for revenues of approximately $160,000, $495,000, and $290,000, respectively.

On March 30, 1998, the Company completed the sale of substantially all of the non-real property assets of Cenci Powder Products to Zuellig Botanical. The purchase price for the assets consisted of the forgiveness by Zuellig Botanical of approximately $262,000 in indebtedness owed by Cenci Powder to Zuellig Botanical related to the purchase of raw materials. The Agreement provided further that Zuellig Botanical would satisfy the manufacture and delivery requirements of Cenci Powder at its facility located at Fresno, California, under an existing third party supply contract.

Sale of Assets

On March 21, 1995, the Company sold its Abbreviated New Drug Application ("ANDA") for 5mg Oxycodone HCL/325mg Acetaminophen Tablets ("Tablets") and certain equipment used in the production of the Tablets for up to $5.4 million to Mallinckrodt. The Company received $500,000 of the proceeds in July 1994, which was recorded as deferred income on the Company's 1994 consolidated balance sheet. Mallinckrodt also paid the Company $2,000,000 on March 21, 1995 and the remainder was to be payable as follows: (i) $1,000,000 upon the Company receiving general clearance from the FDA for unrestricted operations at its Brooklyn facility and written notice from the FDA that it is in compliance with certain provisions of the consent degree dated June 29, 1993 and (ii) $1,900,000 at the earlier of (a) Mallinckrodt receiving certain authorizations from the FDA or (b) September 21, 1997. Mallinckrodt also agreed to defer $1,200,000 of the Company's trade debt due to an affiliate of Mallinckrodt (Note E). Pursuant to the release of the Company from the FDA's Application Integrity Policy list and its Restrictions (collectively, the "AIP") by the FDA on December 19, 1996, the Company recorded a gain of $1,000,000. On January 9, 1997, Mallinckrodt tendered this amount to the Bank Group. Pursuant to the agreement of September 21, 1997, the Company recorded $1,900,000 as a deferred gain which was recognized on March 21, 1998.

In connection with the agreement, the Company agreed to manufacture Tablets for Mallinckrodt for a period of three years and Mallinckrodt agreed to order a minimum number of Tablets from the Company for two years ending March 21, 1997. The Company and Mallinckrodt entered into a noncompetition agreement pursuant to which the Company agreed not to compete with Mallinckrodt and its affiliates with respect to the Tablets until March 21, 2000.

NOTE J -- PENSION EXPENSE

1. Management Pension Plan

The Company had maintained a defined benefit plan covering substantially all nonunion employees which was terminated in November 1996. Subsequently, all Plan assets were converted to cash and held in a money market fund (to continue the Trust) from which all vested participant interests were to be paid. Based on information provided by the Company's actuary, the total liability of the Plan as of the plan year ended November 30, 1997 was $398, 281. The actuary determined that this amount was sufficient to pay the vested interests of all of the participants who were in the Plan as of November 30, 1996, and for any participants who had terminated with previously vested interests that had not yet been paid. Included in the Plan's assets as of November 30, 1997, were receivables from the Company and the Insurer for $54,631 and $57,468, respectively, which were subsequently paid in March 1998. No additional contributions were required to be paid to the Trust for the period ended November 30, 1997.

In 1998 the Company received approval to terminate the Plan by the Pension Benefit Guarantee Corporation, all assets were distributed to the vested participants, the Trust was terminated and a final filing was made with the Internal Revenue Service.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. Employees' Pension Plan

The Company contributed approximately $421,000, $407,000, and $492,000 in 1998, 1997 and 1996, respectively, to a multiemployer pension plan for employees covered by collective bargaining agreements. This plan is not administered by the Company and contributions are determined in accordance with provisions of negotiated labor contracts. Information with respect to the Company's proportionate share of the excess, if any, of the actuarially computed value of vested benefits over the total of the pension plan's net assets is not available from the plan's administrator.

The Multiemployer Pension Plan Amendments Act of 1980 (the "Act") significantly increased the pension responsibilities of participating employers. Under the provision of the Act, if the plans terminate or the Company withdraws, the Company could be subject to a "withdrawal liability."

NOTE K -- STOCK OPTION PLAN

In June 1998, the stockholders of the Company approved the adoption of a stock option and restricted stock purchase plan (the "1998 Option Plan"). The 1998 Option Plan replaces the 1995 Option Plan which was terminated in 1998. The 1998 Option Plan provides for the granting of (i) nonqualified options to purchase the Company's common stock at not less than the fair market value on the date of the option grant, (ii) incentive stock options to purchase the Company's common stock at not less than the fair market value on the date of the option grant and (iii) rights to purchase the Company's common stock on a "Restricted Stock" basis, as defined, at not less than the fair market value on the date the right is granted. As of December 31, 1998, there was no exercise of rights to purchase any common stock on a restricted stock basis. The total number of shares which may be sold pursuant to options and rights granted under the 1998 Option Plan is 2,600,000. No option can be granted under the 1998 Option Plan after April, 2008 and no option can be outstanding for more than ten years after its grant.

The Company has adopted the disclosure provisions of Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation." It applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its plans and does not recognize compensation expense for its stock-based compensation plans other than for restricted stock. Under APB No. 25, because the exercise price of employee stock options has historically been greater than or equal to the market price of the underlying stock on the date of grant, no compensation expense has been recorded. If the Company had elected to recognize compensation expense based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed by SFAS No. 123, the Company's net income and earnings per share would be reduced to the pro forma amounts indicated below:

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
	(THOUSANDS, EXCEPT PER SHARE AMOUNTS)		
Net loss			
As reported	$(12,724)	$(15,013)	$(14,495)
Pro forma	(13,663)	(15,323)	(14,180)
Loss per share			
As reported	$ (.92)	$ (1.12)	$ (1.49)
Pro forma	(.98)	(1.14)	(1.46)

These pro forma amounts may not be representative of future disclosures because they do not take into effect pro forma compensation expenses related to grants made before 1995. The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the years ended December 31, 1998, 1997 and 1996, respectively: expected volatility

of 67%, 65%, and 82%; risk-free interest rates of 5.6%, 6.0%, and 6.6%; and expected lives of 10 years, 4 years and 4.6 years. At the date of grant, all exercise prices equaled the market value of the stock.

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 market 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.

Transactions involving stock options are summarized as follows:

	STOCK OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE FAIR VALUE
Balance at January 1, 1996	600,500	$3.49	
Granted	126,000	4.77	
Exercised	(49,159)	3.12	
Cancelled	(21,334)	4.39	
Balance at December 31, 1996	656,007	3.53	
Exercised	(89,300)	3.22	$3.39
Cancelled	(84,968)	5.16	3.39
Balance at December 31, 1997	481,739	3.60	
Granted	2,254,850	2.37	1.71
Cancelled	(511,303)	3.16	2.08
Balance at December 31, 1998	2,225,286	2.46	

The following table summarizes information concerning currently outstanding and exercisable stock options:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGES OF EXERCISE PRICES	NUMBER OUTSTANDING AT DECEMBER 31, 1998	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT DECEMBER 31, 1998	WEIGHTED AVERAGE EXERCISE PRICE
$1.19 - $2.00	70,000	8.10	$1.55	20,000	$1.97
2.01 - 3.00	2,025,350	9.19	2.40	348,750	2.38
3.01 - 4.88	129,936	7.32	3.86	80,036	3.74
	2,225,286			448,786	

NOTE L -- COMMITMENTS

The Company occupies plant and office facilities under noncancellable operating leases which expire in December 2005. These operating leases provide for scheduled base rent increases over the term of the lease, however, the total amount of the base rent payments will be charged to operations using the straight-line method over the term of the lease. The leases provide for payment of real estate taxes based upon a percentage of the annual increase. In addition, the Company rents certain equipment under operating leases, generally for terms of four years. Total rent expense for the years ended December 31, 1998, 1997 and 1996 was approximately $1,243,000, $884,000 and $659,000, respectively.

As of December 31,1998, the approximate minimum rental commitments under these operating leases are as follows:

	(IN THOUSANDS)
Twelve months ending December 31,	
1999	$1,023
2000	1,075
2001	1,128
2002	1,186
2003 and thereafter	3,921
Total minimum payments required	$8,333

Employment Contracts

During March 1998, the Company entered into employment contracts with each of two new officers/employees of the Company which cover a five-year and a three-year period, respectively. The contracts provide for, among other things: (i) annual salaries of $170,000 and $140,000 to be paid over the five-year and three-year periods, respectively and (ii) an aggregate of 1,300,000 options (included in the 1998 grants -- Note K) to purchase the Company's stock at an exercise price of $2.38 per common share that vest evenly over a three-to-five-year service period and expire in ten years.

NOTE M -- CONTINGENCIES

The Company currently is a defendant in several lawsuits involving product liability and other claims. The Company's insurance carriers have assumed the defense for all product liability and other actions involving the Company. None of the lawsuits is brought as a class action. The ultimate outcome of these lawsuits cannot be determined at this time, and accordingly, no adjustment has been made to the consolidated financial statements. The Company does not believe these actions will have a material adverse effect on the Company's financial condition or results of operations.

On October 23, 1996, the Company withdrew four of its Abbreviated New Drug Applications ("ANDAs") including its ANDA for acetaminophen/oxycodone capsules (the "Capsule ANDA"), and halted sales of the affected products. The Company instituted the withdrawal at the suggestion of the FDA and in anticipation of its release from the FDA's Application Integrity Policy ("AIP"). The FDA has placed the Company on the AIP, in October 1991, in connection with its investigation of the Company's operations which culminated in the 1993 consent decree. Under the AIP, the FDA suspended all of the parent company's (i.e., Halsey Drug Co.'s) applications for new drug approvals, including ANDAs and supplements to ANDAs. At the FDA's suggestion, the Company retained outside consultants to perform validity assessments of its drug applications. Thereafter, in October 1996, the FDA recommended that several applications, including the Capsule ANDA, be withdrawn. As a basis of its decision, the FDA cited questionable and incomplete data submitted in connection with the applications. The FDA indicated that withdrawal of the four ANDAs was necessary for the release of the Company from the AIP. The FDA further required submission by the Company of a Corrective Action Plan. Said Plan was prepared and submitted by the Company and accepted by the FDA during 1997.

On December 19, 1996, the FDA released the Company from the AIP. As a consequence, for the first time since October 1991, the Company was permitted to submit ANDAs to the FDA for review. Since its release from the AIP in December 1996, through the fiscal year ended December 31, 1998, the Company submitted thirteen ANDAs for review by the FDA, including a new ANDA with respect to the Capsules. During the period from the Company's release from the AIP to March 15, 1999, the Company received six ANDA approvals, all of which relate to ANDA filings made with the FDA subsequent to the Company's release from the AIP.

As of March 15, 1999, the Company had submitted one additional ANDA for review by the FDA in fiscal 1999 and anticipates the submission of five additional ANDAs during the balance of fiscal 1999. Although the Company has been successful in receiving the ANDA approvals described above since its release from the AIP in December 1996, there can be no assurance that any of its newly submitted ANDAs, or those contemplated to be submitted, will be approved by the FDA. The Company will not be permitted to market any new product unless and until the FDA approves the ANDA relating to such product. Failure to obtain FDA approval for the Company's pending ANDAs, or a significant delay in obtaining such approval, would adversely affect the Company's business operations and financial condition.

On June 21, 1993, the Company entered into a Plea Agreement with the DOJ to resolve the DOJ's investigation into the manufacturing and record keeping practices of the Company's Brooklyn plant. Under the terms of the Plea Agreement, the Company agreed to plead guilty to five counts of adulteration of drug products shipped in interstate commerce. Each count involved product adulteration, and record keeping deficiencies relating to a single drug product, Quinidine Gluconate (324mg tablets), manufactured at the Brooklyn plant. The Plea Agreement also required the Company to pay a fine of $2,500,000 over five years in quarterly installments of $125,000, commencing on or about September 15, 1993. The Company's plea was entered and the terms of the Plea Agreement were approved by the United States District Court for the District of Maryland on July 13, 1993. As of February 28, 1998, the Company was in default of the payment terms of the Plea Agreement and had made payments aggregating $350,000. On March 27, 1998, the Company and the DOJ signed the Letter Agreement serving to amend the Plea Agreement relating to the terms of the Company's satisfaction of the fine assessed under the Plea Agreement Specifically, the Letter Agreement provided that the Company will satisfy the remaining $2,150,000 of the fine through the payment of $25,000 on a monthly basis commencing June 1, 1998, plus interest on such outstanding balance (at the rate calculated pursuant to 28 U.S.C Section 1961)(currently 5.319%). Such payment schedule will result in the full satisfaction of the DOJ fine in December, 2005. The Letter Agreement also provides certain restrictions on the payment of salary or compensation to any individual in excess of $150,000 without the written consent of the United States District Court for the District of Maryland, subject to certain exceptions. In addition, the Letter Agreement requires the repayment of the outstanding fine to the extent of 25% of the Company's after-tax profit or the remaining balance owed and 25% of the net proceeds received by the Company on any sale of a capital asset for a sum in excess of $10,000. If, at any time, the Company does not make the payments required under the Letter Agreement in a timely fashion, the United States will be free to declare that the fine is delinquent and/or in default, and exercise all legal process to immediately collect the full amount of the fine, interest and applicable penalties. At December 31, 1998 the remaining amount due the DOJ was $1,975,000. The current portion of this debt amounting to $300,000 is shown as "Other current liabilities." The remainder of $1,675,000 is included in "Other liabilities."

By letter dated October 23, 1995, the Company was notified by the New York State Education Department (the "Department") that the Professional Conduct Officer of the Office of Professional Discipline had determined that there was sufficient evidence of professional misconduct on the Company's part to warrant a disciplinary proceeding pursuant to New York law. Upon contacting the Deputy Director of the Office of Professional Discipline, counsel for the Company was advised that the alleged misconduct related to the same activities that were the subject of the DOJ investigation, indictment and plea. The Company submitted a written response on November 16, 1995. The Company and the Department have agreed to the entry of a Consent Order concluding any disciplinary proceedings. The Company will pay $175,000 in fines over five years. In addition, the Company's registration as a manufacturer of drugs in New York State is revoked, but such revocation is stayed and the Company has been placed on probation for a maximum of five years. The Company has the right to apply for removal from probation after two years. At December 31, 1998, the Company is current in its payment obligations with a remaining obligation of $140,000.

The Company's Common Stock is listed on the American Stock Exchange (the "Exchange") under the symbol "HDG."

The Company does not meet certain of the Exchange's criteria for continued listing. Accordingly, there can be no assurance that the Company's common stock will remain listed on the Exchange or that the Exchange will not commence a review of the Company's continued listing eligibility. If the Common Stock should become delisted from the Exchange, trading, if any, in the Common Stock would continue on the OTC Bulletin Board, an NASD-sponsored inter-dealer quotation system, or in what is commonly referred to as the "Pink Sheets." In such event, a shareholder may find it more difficult to dispose of, or to obtain accurate quotations as to the market value of the Common Stock.

Immediately prior to the completion of the Offering, the Company was in default under the consent order with the Department for failure to satisfy two of the monthly installments of the fine as provided in the consent order. Prior to the completion of the Offering, the Company advised the Department as to the existence of the default and that such deficiencies would be corrected upon the completion of the Offering. The Company has satisfied these outstanding amounts and is now current under the consent order with the Department. Based on discussions between representatives of the Department and the Company's outside counsel handling this matter, the Company has been advised that the revocation of the Company's registration as a manufacturer of drugs in the State of New York will remain stayed and that the Company continues to have the right to apply for removal from probation after two years from the effective date of the consent order.

Other Legal Proceedings

Beginning in 1992, actions were commenced against the Company and numerous other pharmaceutical manufacturers in the Pennsylvania Court of Common Pleas, Philadelphia Division, in connection with the alleged exposure to diethylstilbestrol ("DES"). The defense of all of such matters was assumed by the Company's insurance carrier, and a substantial number have been settled by the carrier. Currently, five actions remain pending with the Company as a defendant, and the insurance carrier is defending each action. Similar actions were brought in Ohio, and have been dismissed based on Ohio law. The Company and its legal counsel do not believe any of such actions will have a material impact on the Company's financial condition or results of operations.

The Company has been named as a defendant in four additional actions, each of which has been referred to the Company's carrier and has been accepted for defense. The first action, Alonzo v. Halsey Drug Co., Inc. and K-Mart Corp., No. 64DOT-95111-CT-2736 (Indiana Superior Court, Porter County), was commenced on November 5, 1995 and involves a claim for unspecified damages relating to the alleged ingestion of "Doxycycline 100." At this early stage of the proceedings, the Company is unable to predict with any degree of certainty the likely outcome of these claims and whether they will have a material adverse effect on the Company's financial condition. The second action, Files v. Halsey Drug Co., Index No. 198787193 (New York Supreme Court, Suffolk County), commenced on September 16, 1993, seeking $10,000,000 in damages for wrongful death allegedly caused by the ingestion of Isoniazid. Halsey has been dismissed from this action on motion for summary judgment. The third and fourth actions, entitled Hunt v. Halsey Drug Co., Inc., and McCray v. Halsey Drug Co., Inc. (New York State Supreme Court, Kings County), were commenced on October 21, 1993, seeking the recovery of $8,000,000 for alleged personal injuries suffered by two Wells Fargo security guards who responded to an alarm and were shot, resulting in the death of one and the injury to the other. The Company's insurance carrier and the plaintiffs in these matters have agreed in principle to a settlement providing for the payment by the Company's insurance carrier of the sum of $600,000 to the estate of John McCray and the sum of $150,000 to Joseph Hunt in full and final settlement of all their respective claims against the Company.

The Company has been named as a defendant in a complaint filed with the United States District Court, Eastern District of New York, on June 30, 1998 (the "Complaint") by Quality Products and Services, L.L.C. The Complaint alleges the existence of a Joint Venture Agreement between the Plaintiff and the Company concerning the development, manufacture and marketing of a single product. The Complaint also alleges that the Company has breached the Agreement by failing to satisfy its respective obligations defined in the Agreement. The Complaint seeks monetary damages of approximately $20 million. The Company believes

that the allegations contained in the Complaint are without basis in fact, and that it has meritorious defenses to each of the allegations. The Company has retained counsel and intends to vigorously defend this action. This matter is currently in discovery. The Company has filed a third-party complaint against Rosendo Ferran, the Company's former President, in connection with the Complaint. The ultimate outcome of this action cannot be determined at this time, although the Company does not believe this action will have a material adverse effect on the Company's financial condition or results of operations.

The Company has been named as a defendant in an action in Suffolk County, New York, by Designed Laboratories, Inc., for construction work allegedly performed at the Company's facilities in Brooklyn. Plaintiff is seeking approximately $148,000. The Company has no records of work being performed by this entity, and is therefore defending the action. The Company does not believe this claim will have a material adverse effect on the Company's financial condition or results of operations.

The Company's former President, Rosendo Ferran, has instituted an arbitration against the Company, seeking sums alleged due under his employment contract in the amount of $225,000, deferred salary in the approximate amount of $100,000, and unspecified damages upon allegations of age, ethnic and religious discrimination. The Company believes it has meritorious defenses to the allegations claimed in the arbitration. The Company and its legal counsel do not believe this claim will have a material adverse effect on the Company's financial condition or results of operations.

NOTE N -- SIGNIFICANT CUSTOMERS AND SUPPLIERS

The Company sells its products to a large number of customers who are primarily drug distributors, drugstore chains and wholesalers and are not concentrated in any specific region. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. During 1998, the Company had net sales to one customer in excess of 10% of total sales, aggregating 11.5% of total sales. During 1997, the Company had net sales to two customers in excess of 10% of total sales. One customer (Mallinckrodt) accounted for 22.1% of total sales and another customer (Warner Chilcott) accounted for 10% of total sales. During 1996, the Company had net sales to one customer aggregating 10% of total sales.

During 1998 and 1997, the Company purchases approximated $2,583,000 and $1,187,000, respectively, representing approximately 29% and 25%, respectively, of total purchases for those years.

NOTE O -- SUBSEQUENT EVENTS

Lease of Congers, New York Facility

Effective March 22, 1999, the Company leased, as sole tenant, a pharmaceutical manufacturing facility located in Congers, New York (the "Congers Facility") from Par Pharmaecutical, Inc. ("Par") pursuant to an Agreement to Lease (the "Lease"). The Congers Facility contains office, warehouse and manufacturing space and is approximately 35,000 square feet. The Lease provides for a term of three years, with a two-year renewal option and provides for annual fixed rent of $500,000 per year during the primary term of the Lease and $600,000 per year during the option period. The Lease also covers certain manufacturing and related equipment previously used by Par in its operations at the Congers Facility (the "Leased Equipment"). In connection with the execution of the Lease, the Company and Par entered into a certain Option Agreement pursuant to which the Company may purchase the Congers Facility and the Lease Equipment at any time during the lease term for $5 million.

As part of the execution of the Lease, the Company and Par entered into a certain Manufacturing and Supply Agreement (the "M&S Agreement") having a term of two years. The M&S Agreement provides for the Company's contract manufacture of certain designated products manufactured by Par at the Congers Facility prior to the effective date of the Lease. The M&S Agreement also provides that Par will purchase a minimum of $1,150,000 in product during the initial 18 months of the Agreement. The M&S Agreement further provides that the Company will not manufacture, supply, develop or distribute the designated products to be supplied by the Company to Par under the M&S Agreement to or for any other person for a period of three years.

HALSEY DRUG CO., INC. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

AMOUNTS IN 000'S

DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS DESCRIBE	DEDUCTIONS - DESCRIBE(A)(B)	BALANCE AT END OF PERIOD
YEAR ENDED DECEMBER 31, 1996					
Accounts receivable reserves..................	280	144			424
Inventory reserves...........	155			105	50
YEAR ENDED DECEMBER 31, 1997					
Accounts receivable reserves..................	424	118			542
Inventory reserves...........	50	625			675
YEAR ENDED DECEMBER 31, 1998					
Accounts receivable reserves..................	542			262	280
Inventory reserves...........	675			361	314

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(a) Amounts written off as uncollectible accounts receivable and recoveries.

CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

We have issued our report dated March 5, 1999, accompanying the consolidated financial statements included in the Annual Report of Halsey Drug Co., Inc. on Form 10-K for the year ended December 31, 1998. We hereby consent to the incorporation by reference of said report in the Registration Statements of Halsey Drug Co., Inc. on Form S-8 (File No. 33-98396, effective October 19, 1995).

GRANT THORNTON LLP

New York, New York
March 5, 1999

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

HALSEY DRUG CO., INC.

By /s/ MICHAEL REICHER

Michael Reicher, President and Chief Executive Officer (Principal Executive Officer)

Date: June 11, 1999