ALLERGAN INC
Form 10-K
March 05, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 2003

Commission File No. 1-10269

Allergan, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	**95-1622442**
(State of Incorporation)	*(I.R.S. Employer Identification No.)*
2525 Dupont Drive	**92612**
Irvine, California	*(Zip Code)*
(Address of principal executive offices)	

(714) 246-4500

(Registrant s telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which each class registered**
Common Stock, $0.01 par value Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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, and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o.

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. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).
Yes þ No o.

The aggregate market value of the registrant s common equity held by non-affiliates was approximately $10,081 million on June 27, 2003, based upon the closing price on the New York Stock Exchange on such date.

Common Stock outstanding as of February 27, 2004 134,254,772 shares (including 3,033,468 shares held in treasury).

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant s proxy statement for the annual meeting of stockholders to be held on April 28, 2004, which proxy statement will be filed no later than 120 days after the close of the registrant s fiscal year ended December 31, 2003.

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PART I

Item 1. *Business*

General Development of Our Business

Allergan, Inc. is a technology-driven, global health care company that develops and commercializes specialty pharmaceutical products for the ophthalmic, neurological, dermatological and other specialty markets. We are a pioneer in specialty pharmaceutical research, targeting products and technologies related to specific disease areas such as glaucoma, retinal disease, dry eye, psoriasis, acne and movement disorders. Additionally, we develop and market aesthetic-related pharmaceuticals and over-the-counter products. Within these areas, we are an innovative leader in therapeutic and other prescription products, and to a limited degree, over-the-counter products that are sold in more than 100 countries around the world. We are also focusing research and development efforts on new therapeutic areas, including gastroenterology, neuropathic pain and various types of cancer.

We were originally incorporated in California in 1948 and became known as Allergan Corporation in 1950. In 1977, we reincorporated in Delaware. In 1980, we were acquired by SmithKline Beecham plc (then known as SmithKline Corporation). From 1980 through 1989, we operated as a wholly-owned subsidiary of SmithKline and in 1989 we again became a stand-alone public company through a spin-off distribution by SmithKline.

Our Internet website address is www.allergan.com. We make our periodic and current reports, together with amendments to these reports, available on our Internet website, free of charge, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission. The information on our Internet website is not incorporated by reference in this Annual Report on Form 10-K.

On June 29, 2002, we completed the spin-off of our optical medical device business to our stockholders. The optical medical device business consisted of two businesses: our ophthalmic surgical products business, which developed, manufactured and marketed products that included artificial lenses for the eye, called intraocular lenses, and equipment for cataract and refractive eye surgery; and our contact lens care products business, which developed, manufactured and marketed a broad range of products for use with every available type of contact lens. The spin-off was effected by contributing our optical medical device business to a newly formed subsidiary, Advanced Medical Optics, Inc., and issuing a dividend of Advanced Medical Optics common stock to our stockholders. The Internal Revenue Service ruled that the transaction qualified as tax-free for Allergan and our stockholders for U.S. federal income tax purposes, with the exception of cash received for fractional shares. The common stock of Advanced Medical Optics began trading publicly on the New York Stock Exchange on July 1, 2002 under the symbol AVO. Following the spin-off, we continue to own and operate our specialty pharmaceutical business and Advanced Medical Optics owns and operates what was formerly our optical medical device business. We have no ownership interest in Advanced Medical Optics. Our consolidated financial statements and related notes reflect the financial position, results of operations and cash flows of the optical medical device business as a discontinued operation.

Acquisitions in 2003

On May 16, 2003, we completed the acquisition of all of the outstanding equity interests in Bardeen Sciences Company, LLC from Farallon Pharma Investors, LLC for an aggregate purchase price of approximately $264.6 million, including transaction costs of $1.1 million and $12.8 million in certain intangible contract-based product marketing and other rights, net of cash acquired. The Bardeen acquisition occurred through our exercise of a previously granted equity purchase option that became exercisable on April 7, 2003. The option purchase price was determined pursuant to a formula established at the time of the grant of the equity purchase option in 2001. As a result of the Bardeen acquisition, we acquired all of Bardeen s assets, which consisted of the rights to certain pharmaceutical compounds and research projects.

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On November 20, 2003, we completed the acquisition of Oculex Pharmaceuticals, Inc., a company engaged in developing treatments for sight-threatening diseases of the eye. We acquired the Oculex business for an aggregate purchase price of approximately $223.8 million, net of cash acquired, including transaction costs of $1.6 million and $6.1 million in other assets, comprised principally of notes receivable, an equity investment and certain deferred tax assets related to Oculex. The primary focus of the transaction was our acquisition of a bioerodable, extended release drug delivery technology to deliver drug to the back of the eye, including *Posurdex*®, which is intended to deliver dexamethasone for the treatment of edema. We currently intend to enroll study subjects in Phase 3 clinical trials for *Posurdex*® during the first half of 2004. The Phase 3 clinical trials will focus on macular edema associated with diabetes and other conditions. If these Phase 3 clinical trials are successful, we anticipate potential FDA approval of *Posurdex*® in the late 2006 or early 2007 timeframe.

Our Business

The following table sets forth, for the periods indicated, net sales from continuing operations for each of our specialty pharmaceutical product lines, earnings (loss) from continuing operations, domestic and international sales as a percentage of total net sales and domestic and international long-lived assets:

	Year Ended December 31		
	2003	2002	2001
	(in millions)		
Net Sales by Product Line			
Eye Care Pharmaceuticals	$ 999.5	$ 827.3	$ 753.7
Botox®/ Neuromodulator	563.9	439.7	309.5
Skin Care Products	109.3	90.2	78.9
Other(1)	82.7	27.8	
Total	$1,755.4	$1,385.0	$1,142.1
Earnings (loss) from continuing operations	$ (52.5)	$ 64.0	$ 171.2
Sales			
Domestic	70.4%	70.6%	67.0%
International	29.6%	29.4%	33.0%
Long-Lived Assets (in millions)			
Domestic	$ 573.8	$ 381.2	$ 354.6
International	$ 252.9	$ 225.2	$ 199.3

(1) Other sales primarily consist of sales to Advanced Medical Optics pursuant to the manufacturing and supply agreement entered into as part of the spin-off of Advanced Medical Optics.

See Note 15, Business Segment Information, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report for further information concerning our foreign and domestic operations.

Eye Care Pharmaceutical Product Line

We develop, manufacture and market a broad range of prescription and non-prescription products designed to treat diseases and disorders of the eye, including glaucoma, dry eye, inflammation, infection and allergy.

Glaucoma. The largest segment of the market for ophthalmic prescription drugs is for the treatment of glaucoma, a sight-threatening disease typically characterized by elevated intraocular pressure leading to optic nerve damage. Glaucoma is currently the world s second leading cause of blindness, and we estimate that over 60 million people worldwide have glaucoma. According to IMS Health Inc., an independent research firm, our

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products for the treatment of glaucoma, including *Alphagan*®, *Alphagan*® *P* and *Lumigan*®, captured approximately 18% of the worldwide glaucoma market in 2003.

Our largest selling eye care pharmaceutical products are the ophthalmic solutions *Alphagan*® (brimonidine tartrate ophthalmic solution) 0.2% and *Alphagan*® *P* (brimonidine tartrate ophthalmic solution) 0.15%, preserved with *Purite*®. *Alphagan*® and *Alphagan*® *P* lower intraocular pressure by reducing aqueous humor production and increasing uveoscleral outflow. *Alphagan*® *P* is an improved reformulation of *Alphagan*® containing brimonidine, *Alphagan*® s active ingredient, preserved with *Purite*®. We currently market *Alphagan*® and *Alphagan*® *P* in over 70 countries worldwide.

Alphagan® and *Alphagan*® *P* combined are the second best selling glaucoma products in the world, as measured by 2003 revenue, according to IMS Health Inc. Combined sales of *Alphagan*®and *Alphagan*® *P* represented 16% of our total consolidated sales in 2003, 18% of our total consolidated sales in 2002 and 22% of our total consolidated sales in 2001. In July 2002, based on the overwhelming acceptance of *Alphagan*® *P,* we discontinued the U.S. distribution of *Alphagan*®. The marketing exclusivity period for *Alphagan*® *P* expires in September 2004, although we have a number of patents covering the *Alphagan*® *P* technology that extend to 2021 in the U.S. and 2009 in Europe, with corresponding patents pending in Europe. In May 2003, the first generic form of *Alphagan*® was approved by the FDA. Additionally, a generic form of *Alphagan*® is sold in a limited number of other countries, including Canada, Mexico, India, Brazil and Argentina. See Item 3 of Part I of this report, Legal Proceedings and Note 13, Commitments and Contingencies, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report for further information regarding litigation involving *Alphagan*®. We believe that Falcon Pharmaceuticals, a company affiliated with Alcon Laboratories, Inc., will attempt to obtain FDA approval for and launch a brimonidine product to compete with our *Alphagan*® *P* product in 2005.

In March 2001, the FDA approved *Lumigan*® (bimatoprost ophthalmic solution) 0.03%, a topical treatment indicated for the reduction of elevated intraocular pressure in patients with glaucoma or ocular hypertension who are either intolerant or insufficiently responsive when treated with other intraocular pressure-lowering medications. In March 2002, the European Commission approved *Lumigan*® through its centralized procedure. In January 2004, the European Union s Committee for Proprietary Medicinal Products approved *Lumigan*® as a first-line therapy for the reduction of elevated intraocular pressure in chronic open-angle glaucoma and ocular hypertension. We currently sell *Lumigan*® in over 40 countries worldwide. We have also initiated a process to out-license *Lumigan*® in Japan.

In September 2001, we filed a New Drug Application with the FDA for a brimonidine and timolol combination designed to treat glaucoma. This New Drug Application remains pending. During the fourth quarter of 2003, we received approval from Health Canada for our brimonidine and timolol combination, which is marketed as *Combigan™*. In November 2003, we filed a New Drug Application with the FDA for a *Lumigan*® and timolol combination designed to treat glaucoma or ocular hypertension. This New Drug Application remains pending.

Ocular Surface Disease. In December 2002, the FDA approved *Restasis*® (cyclosporine ophthalmic emulsion) 0.05%, the first and currently the only prescription therapy for the treatment of chronic dry eye disease. We launched *Restasis*® in the United States in April 2003. Dry eye disease is a painful and irritating condition involving abnormalities and deficiencies in the tear film initiated by a variety of causes. The incidence of dry eye disease increases markedly with age, after menopause in women and in people with systemic diseases such as Sjogren s syndrome and rheumatoid arthritis. Until the approval of *Restasis*®, physicians used lubricating tears as a temporary measure to provide palliative relief of the debilitating symptoms of dry eye disease. In June 2001, we entered into a licensing, development and marketing agreement with Inspire Pharmaceuticals, Inc. under which we obtained an exclusive license to develop and commercialize Inspire s INS365 Ophthalmic in exchange for royalty payments to Inspire on sales of both *Restasis*® and, ultimately, INS365. INS365 has completed Phase III clinical trials investigating its ability to relieve the signs and symptoms of dry eye disease by rehydrating conjunctival mucosa and increasing non-lacrimal tear component production. In December 2003, the FDA issued an approvable letter for INS365, although Inspire has reported that the FDA has also requested additional clinical data. We believe that if INS365 is approved, it will be complementary to *Restasis*® in the market.

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Ophthalmic Inflammation. Our leading ophthalmic anti-inflammatory product is *Acular*® (ketorolac ophthalmic solution) 0.5%. *Acular*® is a registered trademark of and is licensed from its developer, Syntex (U.S.A.) Inc., a business unit of F. Hoffmann-LaRoche Inc. *Acular*® is indicated for the temporary relief of itch associated with seasonal allergic conjunctivitis, the inflammation of the mucus membrane that lines the inner surface of the eyelids, and for the treatment of post-operative inflammation in patients who have undergone cataract extraction. *Acular PF*® is the first, and currently remains the only unit-dose, preservative-free topical non-steroidal anti-inflammatory drug in the United States. *Acular PF*® is indicated for the reduction of ocular pain and photophobia following incisional refractive surgery. *Acular*® is the number one prescribed non-steroidal anti-inflammatory in the United States. See Item 3 of Part I of this report, Legal Proceedings and Note 13, Commitments and Contingencies, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report for information regarding our successful patent infringement lawsuit against Apotex, Inc., et al. confirming the validity and enforceability of our intellectual property covering *Acular*®.

In June 2003, we received FDA approval of *Acular LS*™, a reformulated ketorolac 0.4% concentration, for the reduction of ocular pain, burning and stinging following corneal refractive surgery. We launched *Acular LS*™ in the United States in August 2003.

Our product *Pred Forte*® remains a leading topical steroid worldwide based on 2003 sales. *Pred Forte*® has no patent protection or marketing exclusivity and faces generic competition.

Ophthalmic Infection. A leading product in the ophthalmic anti-infective market is our *Ocuflox*®*/ Oflox*®*/ Exocin*® ophthalmic solution. According to Verispan, an independent research firm, this ophthalmic solution was the number one ocular anti-infective prescribed by ophthalmologists in the United States in 2003. The U.S. compound and ophthalmic use patents covering *Ocuflox*® expire in March 2004 and May 2004, respectively.

In March 2003, we received FDA approval of *Zymar* (gatifloxacin ophthalmic solution) 0.3%. *Zymar* is the first fourth-generation fluoroquinilone to enter the market for the treatment of bacterial conjunctivitis. Laboratory studies have shown that *Zymar* kills the most common bacteria that cause eye infections as well as specific resistant bacteria. We launched *Zymar* in the United States in April 2003.

Allergy. The allergy market is, by its nature, a seasonal market, peaking during the spring months. We market *Alocril*® ophthalmic solution for the treatment of itch associated with allergic conjunctivitis. Additionally, in October 2003, we received FDA approval of *Elestat* (epinastine ophthalmic solution) 0.05%, for the prevention of itching associated with allergic conjunctivitis. In December 2003, we announced the execution of an agreement with Inspire Pharmaceuticals for the co-promotion of *Elestat* in the United States within the ophthalmic specialty area and to allergists. Under the terms of the agreement, Inspire provided us with an up-front payment and we will pay royalties to Inspire on *Elestat* net sales. In addition, the agreement reduces our existing royalty payment to Inspire for *Restasis*®. Inspire will have primary responsibility for selling and marketing activities in the United States related to *Elestat.* We have retained all international marketing and selling rights. We plan to launch *Elestat* in Europe under the brand names *Relestat*® and *Purivist*® during the first quarter of 2004, and we anticipate that Inspire will also launch *Elestat*™ in the United States during the first quarter of 2004.

Neuromodulator

Our neuromodulator product, *Botox*® (Botulinum Toxin Type A), is used in a wide variety of treatments which continue to expand. *Botox*® is accepted in many global regions as the standard therapy for indications ranging from therapeutic neuromuscular disorders and related pain to cosmetic facial aesthetics. There are currently in excess of 100 therapeutic and cosmetic indications for *Botox*® based on its localized treatment effect and approximately 20 years of safety experience in large patient groups. Marketed as *Botox*®, *Botox*® Cosmetic or *Vistabel*®, depending on the indication and country of approval, the product is approved in over 70 countries for a broad range of indications. Sales of *Botox*® represented approximately 32%, 32% and 27% of our total consolidated sales in 2003, 2002 and 2001, respectively.

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Botox®**.** Botox® is used therapeutically in the treatment of certain neuromuscular disorders which are characterized by involuntary muscle contractions or spasms. The approved therapeutic indications for *Botox*® in the United States are as follows:

blepharospasm, the uncontrollable contraction of the eyelid muscles which can force the eye closed and result in functional blindness;

strabismus, or misalignment of the eyes, in people 12 years of age and over; and

cervical dystonia, or sustained contractions or spasms of muscles in the shoulders or neck in adults, along with the associated pain.

In certain countries outside of the United States, *Botox*® is also approved for treating blepharospasm, strabismus, cervical dystonia, hemifacial spasm, pediatric cerebral palsy, hyperhidrosis (excessive sweating) and upper limb spasticity associated with debilities occurring after a stroke. We are pursuing new approved indications for *Botox*® in the United States, Japan and Europe, including hyperhidrosis (excessive sweating), headache, back spasm and spasticity. In July 2003, we achieved two *Botox*® milestones. We filed with the FDA the Biologics License Application (BLA) supplement for the use of *Botox*® for hyperhidrosis in the United States, and we received a positive opinion in the Mutual Recognition Process (MRP) for *Vistabel*® for seven additional European countries.

The European Commission has granted *Botox*® a positive opinion for focal spasticity of the wrist and hand in adult post-stroke patients. Health Canada has also approved *Botox*® for the management of focal spasticity, including the treatment of upper limb spasticity associated with adult post-stroke patients. In addition, *Botox*® has been granted approval for hyperhidrosis in Canada, Australia, New Zealand and several European countries. To date, the European countries that have approved *Botox*® for hyperhidrosis are Austria, Belgium, Denmark, Finland, France, Germany, Iceland, Luxembourg, the Netherlands, Portugal, Sweden, Switzerland and the United Kingdom.

Botox® *Cosmetic.* The FDA approved *Botox*® in April 2002 for the temporary improvement in the appearance of moderate to severe glabellar lines in adult men and women age 65 or younger. Referred to as *Botox*®*, Botox*® Cosmetic or *Vistabel*®, depending on the country of approval, this product is designed to relax wrinkle-causing muscles to smooth the deep, persistent, glabellar lines between the brow that often develop during the aging process. Health Canada approved *Botox*® Cosmetic for similar use in Canada in April 2001. In 2003, we continued our previously launched direct-to-consumer marketing campaigns in Canada and the United States. These campaigns included television commercials, radio advertising and print advertising aimed at consumers and aesthetic specialty physicians. Since its FDA approval in the United States, approximately 25 other countries have approved the glabellar line indication for *Botox*®, *Botox*® Cosmetic or *Vistabel*®, depending on the country of approval, including Australia, Brazil, Canada, Denmark, France, Israel, Mexico, Norway, Poland, Portugal, Spain, Sweden, and Switzerland. We now sponsor training of aesthetic-oriented physicians in approved countries to further expand the base of qualified physicians using *Botox*®*, Botox*® Cosmetic or *Vistabel*®.

Skin Care Product Line

Our skin care product line focuses on the high growth, high margin segments of the acne and psoriasis markets, particularly in the United States and Canada.

Tazarotene Products. Since 1997, we have marketed *Tazorac*® gel in the United States for the treatment of plaque psoriasis, a chronic skin disease characterized by dry red patches, and acne. We have marketed the cream formulation of *Tazorac*® for the treatment of psoriasis since its FDA approval in October 2000. In September 2001, we received FDA approval to market *Tazorac*® cream for the topical treatment of acne. Under a co-promotion agreement for *Tazorac*® in the United States, Procter & Gamble Pharmaceuticals Inc. markets *Tazorac*® primarily to the general practitioner market and we market *Tazorac*® to dermatologists currently covered by our in-house sales force. We have also engaged Pierre Fabre Dermatologie as our promotion partner for *Zorac*® in certain parts of Europe, the Middle East and Africa.

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In October 2002, we received FDA approval of *Avage™*. *Avage™* is a tazarotene cream indicated for the treatment of facial fine wrinkling, mottled hypo- and hyperpigmentation (blotchy skin discoloration) and benign facial lentigines (flat patches of skin discoloration) in patients using a comprehensive skin care and sunlight avoidance program. We launched *Avage™* in the United States in January 2003.

In November 2003, we filed a New Drug Application with the FDA for oral tazarotene for the treatment of moderate to very severe psoriasis. This New Drug Application remains pending. We also announced our intention to initiate a process to out-license the tazarotene molecule for indications in both psoriasis and acne outside North America. In North America, we currently intend to seek a development partner for our oral tazarotene acne Phase 3 clinical trials.

Azelex®. *Azelex®* cream is approved for the topical treatment of mild to moderate inflammatory acne vulgaris. We launched *Azelex®* cream in the United States in December 1995.

M.D. Forte®. We also develop and market glycolic acid-based skin care products. Our *M.D. Forte®* line of alpha hydroxy acid products are marketed to and dispensed by physicians.

Finacea®. In 2003 we entered into a collaboration with Berlex, Inc. to jointly promote Berlex s topical rosacea treatment, *Finacea®* (azelaic acid gel 15%). *Finacea®* is the first new therapeutic class option to be approved for the treatment of rosacea in more than a decade and has rapidly gained a leading position in the market.

Employee Relations

At December 31, 2003, we employed approximately 4,930 persons throughout the world, including approximately 2,430 in the United States. None of our U.S.-based employees are represented by unions. We believe that our relations with our employees are generally very good.

International Operations

Our international sales of specialty pharmaceutical products have represented 29.6%, 29.4% and 33.0% of total sales for the years ended December 31, 2003, 2002 and 2001, respectively. Our products are sold in over 100 countries. Marketing activities are coordinated on a worldwide basis, and resident management teams provide leadership and infrastructure for customer-focused, rapid introduction of new products in the local markets.

Sales and Marketing

We maintain a global marketing team, as well as regional sales and marketing organizations. We also engage contract sales organizations to promote certain products. Our sales efforts and promotional activities are primarily aimed at eye care professionals, neurologists, plastic surgeons and dermatologists who use, prescribe and recommend our products. We advertise in professional journals and have an extensive direct mail program of descriptive product literature and scientific information that we provide to specialists in the ophthalmic, dermatological and movement disorder fields. We have developed training modules and seminars to update physicians regarding evolving technology in our products. We have also utilized direct-to-consumer advertising for our *Botox®* Cosmetic and *Refresh®* products.

Our products are sold to drug wholesalers, independent and chain drug stores, pharmacies, commercial optical chains, opticians, mass merchandisers, food stores, hospitals, ambulatory surgery centers and medical practitioners, including ophthalmologists, neurologists, dermatologists, pediatricians and plastic surgeons. As of December 31, 2003, we employed approximately 1,300 sales representatives throughout the world. In 2003, for the sixth year in a row, an independent survey of U.S. ophthalmologists ranked our sales force No. 1 in terms of product knowledge and service. We also utilize distributors for our products in smaller international markets.

Sales to Cardinal Healthcare for the years ended December 31, 2003, 2002 and 2001 were 14.0%, 14.8% and 15.1%, respectively, of our total consolidated product net sales. Sales to McKesson Drug Company for the

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years ended December 31, 2003, 2002 and 2001 were 14.2%, 13.3% and 13.4%, respectively, of our total consolidated product net sales. No other country, or single customer, generates over 10% of our total product net sales.

Research and Development

Our global research and development efforts currently focus on eye care, skin care, neuromodulator and other neurologic and gastroenterology candidates. Our own research and development activities are supplemented by a commitment to identify and obtain new technologies through in-licensing, technological collaborations, joint ventures and acquisition efforts, including the establishment of research relationships with biotechnology companies, academic institutions and individual researchers.

As of December 31, 2003, there were, in the aggregate, approximately 1,060 employees involved in our research and development efforts. Our research and development expenditures for 2003, 2002 and 2001 were $763.5 million, $233.1 million and $227.5 million, respectively, including amounts spent by us as in-process research and development expenditures in conjunction with our 2003 acquisitions of Bardeen Sciences Company, LLC and Oculex Pharmaceuticals, Inc., as well as our 2001 acquisition of Allergan Specialty Therapeutics, Inc. Excluding in-process research and development expenditures made in conjunction with the foregoing acquisitions, we have increased our investment in research and development by over $200 million in the past five years, dedicating approximately 20% of our investment in research and development to the discovery of new compounds. In 2002, we dedicated a new research and development facility in France, and we are nearing completion of a major new research and development facility in Irvine, California, which we expect will be completed in 2004 at an aggregate cost of approximately $75 million. In 2004, we began construction on a new biologics facility to be located on our Irvine, California campus. We expect that this facility will be completed in 2005 at an aggregate cost of approximately $50 million.

Our strategy is to expand our leadership role in the science of neuromodulators, develop new potential compounds for sight-threatening diseases such as glaucoma and age-related macular degeneration, as well as pain and gastroenterology, build on our strong market positions in therapeutic dry eye products and dermatology products for acne and psoriasis, and explore new therapeutic areas that are consistent with our specialty pharmaceutical focus.

Eye Care Research and Development. Our research and development efforts for the ophthalmic pharmaceuticals business focus primarily on new therapeutic products for glaucoma and dry eye, and pharmaceuticals and related drug delivery technology for back-of-the eye disorders, including macular degeneration and edema.

Neuromodulator Research and Development. We continue to invest heavily in the research and development of neuromodulators, primarily *Botox*®. We are focused on both expanding the approved indications for *Botox*® and pursuing new neuromodulator-based therapeutics. This includes expanding the approved uses for *Botox*® to include treatment for spasticity, headache, brow furrow, smooth muscle disorders and hyperhidrosis. In collaboration with the Centre for Applied Microbiology & Research, we are focused on engineering neuromodulators for the treatment of severe pain. We are also continuing our investment in the areas of biologic process development and manufacturing.

Skin Care Research and Development. Our research and development team for our skin care business is working on expanded indications and formulations for tazarotene, including an oral form of tazarotene. This oral form of tazorotene is a receptor selective retinoid agonist used for the treatment of moderate to very severe psoriasis and is currently under FDA review. We are committed to expanding the uses of our tazarotene compound. We have, however, initiated a process to divest our other early stage retinoid technology.

In November 2002, we entered into a research collaboration and license agreement with Peplin Biotech Ltd. for the right to develop and commercialize PEP005 for the topical treatment of non-melanoma skin cancer and actinic keratosis. This small molecule has shown early promise for the treatment of a wide range of human cancers, including non-melanoma and other skin cancers.

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Other Areas of Research and Development. We are also working to leverage our technologies in therapeutic areas outside of our current specialties, such as the use of alpha agonists for the treatment of neuropathic pain. Additionally, we are developing a novel proton pump inhibitor designed to reduce excess stomach acid secretion.

In December 2002, we entered into a strategic research collaboration and license agreement with ExonHit Therapeutics. The goals of this collaboration are to identify new molecular targets based on ExonHit Therapeutics gene profiling *DATAS*™ technology and to work collaboratively developing unique compounds and commercial products based on these targets. Our strategic alliance with ExonHit Therapeutics provides us with the rights to compounds developed in the fields of neurodegenerative disease, pain and ophthalmology.

The continuing introduction of new products supplied by our research and development efforts and in-licensing opportunities are critical to our success. There are intrinsic uncertainties associated with research and development efforts and the regulatory process. We cannot assure you that any of the research projects or pending drug marketing approval applications will result in new products that we can commercialize. Delays or failures in one or more significant research projects and pending drug marketing approval applications could have a material adverse affect on our future operations.

Manufacturing

We manufacture the majority of our commercial products in our own plants located in Waco, Texas; Westport, Ireland; and Sao Paulo, Brazil. We maintain sufficient manufacturing capacity at these facilities to support forecasted demand as well as a modest safety margin of additional capacity to meet peaks of demand and sales growth in excess of expectations. We increase our capacity as required in anticipation of future sales increases. In the event of a very large or very rapid unforeseen increase in market demand for a specific product or technology, supply of that product or technology could be negatively impacted until additional capacity is brought on line. Third parties manufacture a small number of commercial products for us. However, the revenues from these products are not material to our operating results.

We are vertically integrated into the production of plastic parts and produce our own bottles, tips and caps for use in the manufacture of our ophthalmic solutions. Additionally, we ferment, purify and characterize the botulinum toxin used in our product *Botox*®. With these two exceptions, we purchase all other raw materials from qualified domestic and international sources. These raw materials consist of active pharmaceutical ingredients, pharmaceutical excipients, and packaging components. Where practical, we maintain more than one supplier for each material, and we have an ongoing alternate sourcing endeavor that identifies additional sources of key raw materials. In some cases, however, most notably with active pharmaceutical ingredients, we are a niche purchaser of specialty chemicals, which are sole sourced. These sources are identified in filings with regulatory agencies, including the FDA, and cannot be changed without prior regulatory approval. In these cases, we maintain inventories of the raw material itself and precursor intermediates to mitigate the risk of interrupted supply. A lengthy interruption of the supply of one of these materials could adversely affect our ability to manufacture and supply commercial product. A small number of the raw materials required to manufacture certain of our products are derived from biological sources which could be subject to contamination and recall by their suppliers. We use multiple lots of these raw materials at any one time in order to mitigate such risks. However, a shortage, contamination or recall of these products could disrupt our ability to maintain an uninterrupted commercial supply of our finished goods.

Competition

We face significant competition in all of our markets worldwide. Numerous companies are engaged in the development, manufacture and marketing of health care products competitive with those that we manufacture. Our major eye care competitors include Alcon Laboratories, Inc., Bausch & Lomb, Pfizer, Novartis Ophthalmics and Merck & Co., Inc. These competitors have equivalent or, in most cases, greater resources than us. Our skin care business competes against a number of companies, including among others, Dermik, a division of Aventis, Galderma, a joint venture between Nestle and L Oreal, Bristol-Myers Squibb, Schering-Plough Corporation, Johnson & Johnson and Hoffman-La Roche Inc., all of which have greater resources

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than us. In the market for neuromodulators, we have three competitors, including Beaufour Ipsen Ltd., which sells products in Europe, Latin America, Asia, Australia and New Zealand, Elan Pharmaceuticals, which sells products in the United States and Europe, and a Chinese entity which sells products in limited countries in Asia and Latin America. In marketing our products to health care professionals, pharmacy benefits management companies, health care maintenance organizations, and various other national and regional health care providers and managed care entities, we compete primarily on the basis of product technology and price. We believe that we compete favorably in our product markets.

Government Regulation

Cosmetics, drugs and biologics are subject to regulation by the FDA, state agencies and, in varying degrees, by foreign health agencies. Pharmaceutical products and biologics are subject to extensive pre- and post-market regulation by the FDA, including regulations that govern the testing, manufacturing, safety, efficacy, labeling, storage, record keeping, advertising and promotion of the products under the Federal Food, Drug and Cosmetic Act and the Public Health Services Act, and by comparable agencies in a number of foreign countries. The process required by the FDA before a new drug or biologic may be marketed in the United States generally involves the following: completion of preclinical laboratory and animal testing; submission of an Investigational New Drug Application, which must become effective before clinical trials may begin; and performance of adequate and well controlled human clinical trials to establish the safety and efficacy of the proposed drug or biologic for its intended use. Approval by the FDA of a New Drug Application is required prior to marketing a new drug, and approval of a Biologics License Application is required before a biologic may be legally marketed in the United States. Both New Drug Applications and Biologics License Applications must also contain extensive manufacturing information. Satisfaction of FDA pre-market approval requirements typically takes several years and the actual time required may vary substantially based on the type, complexity and novelty of the product.

Once approved, the FDA may withdraw product approval if compliance with pre- and post-market regulatory standards is not maintained or if problems occur after the product reaches the marketplace. In addition, the FDA may require post-marketing clinical studies to monitor the effect of approved products. The FDA may limit further marketing of the product based on the results of these post-market studies. The FDA has broad post-market regulatory and enforcement powers, including the authority to levy fines and civil penalties, suspend or delay the issuance of approvals, seize or recall products, and withdraw approvals, any one or more of which could have a material adverse effect upon us.

The FDA imposes a number of complex regulatory requirements on entities that advertise and promote pharmaceuticals and biologics, including, but not limited to, standards and regulations for direct-to-consumer advertising, off-label promotion, industry sponsored scientific and educational activities, and promotional activities involving the Internet. The FDA has very broad enforcement authority under the Federal Food, Drug, and Cosmetic Act, and failure to abide by these regulations can result in penalties, including the issuance of a warning letter directing us to correct deviations from FDA standards, a requirement that future advertising and promotional materials be pre-cleared by the FDA, and state and federal civil and criminal investigations and prosecutions.

We are also subject to various laws and regulations regarding laboratory practices, the experimental use of animals, and the use and disposal of hazardous or potentially hazardous substances in connection with our research. In each of these areas, as above, the FDA has broad regulatory and enforcement powers, including the ability to levy fines and civil penalties, suspend or delay the issuance of approvals, seize or recall products, and withdraw approvals, any one or more of which could have a material adverse effect upon us.

Internationally, the regulation of drugs is also complex. In Europe, our products are subject to extensive regulatory requirements. As in the United States, the marketing of medicinal products has for many years been subject to the granting of marketing authorizations by medicine agencies. Particular emphasis is also being placed on more sophisticated and faster procedures for reporting adverse events to the competent authorities. The European Union procedures for the authorization of medicinal products are currently being reviewed by the European Commission and proposals for improving the efficiency of operation of both the

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mutual recognition and centralized procedure are expected. Additionally, new rules have been introduced or are under discussion in several areas, such as the harmonization of clinical research laws and the law relating to orphan drugs and orphan indications. Outside the United States, reimbursement pricing is typically regulated by government agencies.

In Japan, where we currently sell *Botox*®, the regulatory process is at least equally complex. Pre-marketing approval and clinical studies are required, as is negotiated governmental pricing for pharmaceuticals. The regulatory regime for pharmaceuticals in Japan has historically been lengthy and costly, primarily because Japan required the repetition of all relevant clinical studies in Japan. Japan is in the process of implementing changes to comply with the International Conference on Harmonization, an agreement among Japan, the United States and the European Union to facilitate the registration of drugs utilizing data collected outside of the country. The timeline for completion of these changes and the rules during this transitional period are not certain. During this transitional period, registration of pharmaceutical products will remain unpredictable.

The total cost of providing health care services has been and will continue to be subject to review by governmental agencies and legislative bodies in the major world markets, including the United States, which are faced with significant pressure to lower health care costs. The Medicare Prescription Drug Modernization Act of 2003 imposed certain reimbursement restrictions on our products in the United States. These reimbursement restrictions or other price reductions or controls could materially and adversely affect our revenues and financial condition. Additionally, price reductions and rebates have recently been mandated in several European countries, principally Germany and Italy. Certain products are also no longer eligible for reimbursement in France and Italy. Reference pricing is used in several markets around the world to reduce prices. Furthermore, parallel trade within the European Union, whereby products flow from relatively low-priced to high-priced markets, have been increasing.

We cannot predict the likelihood or pace of any significant regulatory or legislative action in these areas, nor can we predict whether or in what form health care legislation being formulated by various governments will be passed. Medicare reimbursement rates are subject to change at any time. We also cannot predict with precision what effect such governmental measures would have if they were ultimately enacted into law. However, in general, we believe that such legislative activity will likely continue. If adopted, such measures can be expected to have an impact on our business.

Patents, Trademarks and Licenses

We own, or are licensed under numerous U.S. and foreign patents relating to our products, product uses and manufacturing processes. We believe that our patents and licenses are important to our business, but that with the exception of the U.S. and European patents relating to *Lumigan*®, *Acular*®, *Alphagan*® *P* and *Ocuflox*®, no one patent or license is currently of material importance in relation to our overall sales. The U.S. compound and ophthalmic use patents covering *Lumigan*® currently expire in 2012. An application is pending with the U.S. Patent and Trademark Office for a patent term extension for *Lumigan*®. The European patent covering *Lumigan*® expires in various countries between 2013 and 2017. The U.S. patent covering the commercial formulation of *Acular*® expires in 2009; and in 2008 in Europe. The U.S. patents covering the commercial formulation of *Alphagan*® *P* expire in 2012 and 2021; and in 2009 in Europe, with corresponding patents pending. Because we received 6-month exclusivity extensions from the FDA for pediatric use, the U.S. compound and ophthalmic use patents covering *Ocuflox*® expire in March 2004 and May 2004, respectively. Certain European compound patents covering *Ocuflox*® expired in 2003, and others will expire in 2007.

Our success with our products will depend, in part, on our ability to obtain, and successfully defend if challenged, patent or other proprietary protection. However, the issuance of a patent is not conclusive as to its validity or as to the enforceable scope of the claims of the patent. Accordingly, our patents may not prevent other companies from developing similar or functionally equivalent products or from successfully challenging the validity of our patents. Hence, if our patent applications are not approved or, even if approved, such patents are circumvented or not upheld in a legal proceeding, our ability to competitively exploit our patented

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products and technologies may be significantly reduced. Also, such patents may or may not provide competitive advantages for their respective products or they may be challenged or circumvented by competitors, in which case our ability to commercially exploit these products may be diminished.

From time to time, we may need to obtain licenses to patents and other proprietary rights held by third parties to develop, manufacture and market our products. If we are unable to timely obtain these licenses on commercially reasonable terms, our ability to commercially exploit such products may be inhibited or prevented. See Certain Factors and Trends Affecting Allergan and its Businesses We may be subject to intellectual property litigation and infringement claims, which could cause us to incur significant expenses and losses or prevent us from selling our products.

We also rely on trade secrets and proprietary know-how that we seek to protect, in part, through confidentiality agreements with our partners, customers, employees and consultants. It is possible that these agreements will be breached or will not be enforceable in every instance, and that we will not have adequate remedies for any such breach. It is also possible that our trade secrets will otherwise become known or independently developed by competitors.

We may find it necessary to initiate litigation to enforce our patent rights, to protect our trade secrets or know-how or to determine the scope and validity of the proprietary rights of others. Litigation involving patents, trademarks, copyrights and proprietary technologies can often be protracted and expensive and, as with litigation generally, the outcome is inherently uncertain. See Item 3 of Part I of this report, Legal Proceedings and Note 13, Commitments and Contingencies, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report for information concerning our current patent litigation.

We market our products under various trademarks, for which we have both registered and unregistered trademark protection in the United States and certain countries outside the United States. We consider these trademarks to be valuable because of their contribution to the market identification of our products.

Environmental Matters

We are subject to federal, state, local and foreign environmental laws and regulations. We believe that our operations comply in all material respects with applicable environmental laws and regulations in each country where we have a business presence. Although we continue to make capital expenditures for environmental protection, we do not anticipate any significant expenditure in order to comply with such laws and regulations that would have a material impact on our earnings or competitive position. We are not aware of any pending litigation or significant financial obligations arising from current or past environmental practices that are likely to have a material adverse effect on our financial position. We cannot assure you, however, that environmental problems relating to properties owned or operated by us will not develop in the future, and we cannot predict whether any such problems, if they were to develop, could require significant expenditures on our part. In addition, we are unable to predict what legislation or regulations may be adopted or enacted in the future with respect to environmental protection and waste disposal.

Seasonality

Our business, taken as a whole, is not materially affected by seasonal factors, although we have noticed a trend with respect to sales of our *Botox*® product. Specifically, sales of *Botox*® tend to be lowest during the first fiscal quarter, with sales during the second and third fiscal quarters being comparable and marginally higher than sales during the first fiscal quarter. *Botox*® sales during the fourth fiscal quarter tend to be the highest due to patients obtaining their final therapeutic treatment at the end of the year, presumably to fully utilize deductibles and to receive additional cosmetic treatments prior to the holiday season.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES

Statements made by us in this report and in other reports and statements released by us that are not historical facts constitute forward-looking statements within the meaning of Section 27A of the Securities

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Act of 1933, Section 21 of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. These forward-looking statements are necessarily estimates reflecting the best judgment of senior management and include comments which express our opinions about trends and factors which may impact future operating results. Disclosures which use words such as we believe, anticipate, estimate, intend, could, plan, expect and similar expressions are intended to identify forward-looking statements. Such statements rely on a number of assumptions concerning future events, many of which are outside of our control, and involve risks and uncertainties that could cause actual results to differ materially from opinions and expectations. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in context with the various disclosures made by us about our businesses including, without limitation, the risk factors discussed below. We do not plan to update any such forward-looking statements and expressly disclaim any duty to update the information contained in this filing except as required by law.

We operate in a rapidly changing environment that involves a number of risks. The following discussion highlights some of these risks and others are discussed elsewhere in this report. These and other risks could materially and adversely affect our business, financial condition, prospects, operating results or cash flows.

We operate in a highly competitive business.

The pharmaceutical industry is highly competitive. This competitive environment requires an ongoing, extensive search for technological innovation. It also requires, among other things, the ability to effectively market and otherwise promote products, including communications regarding the effectiveness, safety and value of products to actual and prospective customers. Our competitors often have greater resources than us. This enables them, among other things, to spread their research and development costs over a broader revenue base. In addition to product development and effective promotion, other competitive factors in the pharmaceutical industry include industry consolidation, product quality and price, reputation, customer service and access to technical information. It is possible that developments by our competitors could make our products or technologies noncompetitive or obsolete. In addition, competition from generic drug manufacturers is a major challenge in the United States and is growing internationally. For instance, we believe that Falcon Pharmaceuticals, a company affiliated with Alcon Laboratories, Inc., will attempt to obtain FDA approval for and launch a brimonidine product to compete with our *Alphagan® P* product in 2005.

Until December 2000, *Botox®* was the only neuromodulator approved by the FDA. At that time, the FDA approved *Myobloc®*, a neuromodulator marketed by Elan Pharmaceuticals. We believe that Beaufour Ipsen Ltd. intends to seek FDA approval of its *Dysport®* neuromodulator for certain therapeutic indications, while Beaufour Ipsen s marketing partner, Inamed Corporation, intends to seek FDA approval of *Dysport®* for cosmetic indications. Beaufour Ipsen has marketed *Dysport®* in Europe since 1991, prior to our European commercialization of *Botox®* in 1992. In addition, we are aware of competing neuromodulators currently being developed and commercialized in Asia, Europe, South America and other markets. A Chinese entity received approval to market a botulinum toxin in China in 1997 and has launched, or we believe is planning to launch, its botulinum toxin product in other lightly regulated markets in Asia and South America. These lightly regulated markets may not require adherence to good manufacturing practice regulations promulgated by the FDA, the European Medical Evaluation Agency or other regulatory agencies in countries that are members of the Organization for Economic Cooperation and Development. In addition, a German company is seeking German regulatory approval for a botulinum toxin currently expected to be launched during the second half of 2005, and a Korean company may be developing a botulinum toxin currently expected to be launched in Korea in 2004. Our sales of *Botox®* could be materially and negatively impacted by this competition or competition from other companies that might obtain FDA approval or approval from other regulatory authorities to market a neuromodulator.

Botox® Cosmetic is a consumer product. If we fail to anticipate, identify or to react to competitive products or if consumer preferences in the cosmetic marketplace shift to other treatments for the temporary improvement in the appearance of moderate to severe glabellar lines, we may experience a decline in demand for *Botox®* Cosmetic. In addition, the popular media has at times in the past, and may continue in the future, to produce negative reports on the efficacy, safety or side effects of *Botox®* Cosmetic. Consumer perceptions of *Botox®* Cosmetic may be negatively impacted for this and other reasons, thereby causing demand to decline.

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We could experience difficulties creating the raw material needed to produce Botox®.

The manufacturing process to create the raw material necessary to produce *Botox*® is technically complex and requires significant lead-time. Any failure by us to forecast demand for, or maintain an adequate supply of, the raw material and finished product could result in an interruption in the supply of *Botox*® and a resulting decrease in sales of the product.

We may experience losses due to product liability claims, product recalls or corrections.

The design, development, manufacture and sale of our products involve an inherent risk of product liability claims by consumers and other third parties. We have in the past been, and continue to be, subject to various product liability claims. In addition, we have in the past and may in the future recall or issue field corrections related to our products due to manufacturing deficiencies, labeling errors or other safety or regulatory reasons. We cannot assure you that we will not experience material losses due to product liability claims, product recalls or corrections. Additionally, our products may cause, or may appear to cause, serious adverse side effects or potentially dangerous drug interactions if misused or improperly prescribed. These events, among others, could result in additional regulatory controls that could limit the circumstances under which our products are prescribed or could even lead to the withdrawal of a product from the market. Furthermore, any adverse publicity associated with such an event could cause consumers to seek other alternatives to our products, even if our products are ultimately determined not to have been the primary cause of the event, thereby decreasing our sales.

Health care initiatives and other cost-containment pressures could cause us to sell our products at lower prices, resulting in less revenue to us.

Some of our products are purchased or reimbursed by state and federal government authorities, private health insurers and other organizations, such as health maintenance organizations, or HMOs, and managed care organizations, or MCOs. Third party payors increasingly challenge pharmaceutical product pricing. The trend toward managed healthcare in the United States, the growth of organizations such as HMOs and MCOs, and various legislative proposals and enactments to reform healthcare and government insurance programs, including the Medicare Prescription Drug Modernization Act of 2003, could significantly influence the purchase of pharmaceutical products, resulting in lower prices and/or a reduction in demand. Such cost containment measures and healthcare reforms could adversely affect our ability to sell our products. Furthermore, individual states have become increasingly aggressive in passing legislation and regulations designed to control pharmaceutical product pricing, including price or patient reimbursement constraints, discounts, restrictions on certain product access, importation from other countries and bulk purchasing. Legally mandated price controls or restrictions could negatively and materially impact our revenues and financial condition. We encounter similar regulatory and legislative issues in most other countries outside the United States.

We are subject to risks arising from currency exchange rates, which could increase our costs and may cause our profitability to decline.

We collect and pay a substantial portion of our sales and expenditures in currencies other than the U.S. dollar. Therefore, fluctuations in foreign currency exchange rates affect our operating results. We cannot assure you that future exchange rate movements, inflation or other related factors will not have a material adverse effect on our sales, gross profit or operating expenses.

We are subject to risks associated with doing business internationally.

Our business is subject to certain risks inherent in international business, many of which are beyond our control. These risks include:

adverse changes in tariff and trade protection measures;

unexpected changes in foreign regulatory requirements;

potentially negative consequences from changes in tax laws;

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differing labor regulations;

changing economic conditions in countries where our products are sold or manufactured or in other countries;

exchange rate risks;

restrictions on the repatriation of funds;

political unrest and hostilities;

differing degrees of protection for intellectual property; and

difficulties in coordinating and managing foreign operations.

Any of these factors could have a material adverse effect on our business, financial condition and results of operations. We cannot assure you that we can successfully manage these risks or avoid their effects.

If we are unable to obtain and maintain adequate patent protection for the technologies incorporated into our products, our business and results of operations could suffer.

Patent protection is generally important in the pharmaceutical industry. Therefore, our future financial success may depend in part on obtaining patent protection for technologies incorporated into our products. We cannot assure you that such patents will be issued, or that any existing or future patents will be of commercial benefit. In addition, it is impossible to anticipate the breadth or degree of protection that any such patents will afford, and we cannot assure you that any such patents will not be successfully challenged in the future. If we are unsuccessful in obtaining or preserving patent protection, or if any of our products rely on unpatented proprietary technology, we cannot assure you that others will not commercialize products substantially identical to such products. Generic drug manufacturers are challenging the patents covering several of our products. We also rely on trade secrets and proprietary know-how that we seek to protect, in part, through confidentiality agreements with third parties, including partners, customers, employees and consultants. It is possible that these agreements will be breached or that they will not be enforceable in every instance, and that we will not have adequate remedies for any such breach. It is also possible that our trade secrets will become known or independently developed by our competitors.

We may be subject to intellectual property litigation and infringement claims, which could cause us to incur significant expenses and losses or prevent us from selling our products.

Although we have a corporate policy not to infringe the valid and enforceable patents of others, we cannot assure you that our products will not infringe patents held by third parties. In such event, licenses from those third parties may not be available or may not be available on commercially attractive terms. We may have to defend, and have recently defended, against charges that we violated patents or the proprietary rights of third parties. Litigation is costly and time-consuming, and diverts the attention of our management and technical personnel. In addition, if we infringe the intellectual property rights of others, we could lose our right to develop, manufacture or sell products or could be required to pay monetary damages or royalties to license proprietary rights from third parties. An adverse determination in a judicial or administrative proceeding or a failure to obtain necessary licenses could prevent us from manufacturing or selling our products, which could harm our business, financial condition, prospects, results of operations and cash flows. See Item 3 of Part I of this report, Legal Proceedings and Note 13, Commitments and Contingencies, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report for information on current patent litigation.

The consolidation of drug wholesalers could increase pricing and competitive pressures on pharmaceutical manufacturers, including us.

We sell our pharmaceutical products primarily through wholesalers. These customers comprise a significant part of the distribution network for pharmaceutical products in the United States. This distribution network is continuing to undergo significant consolidation marked by mergers and acquisitions. As a result, a smaller number of large wholesale distributors control a significant share of the market. We expect that consolidation of drug wholesalers will increase pricing and competitive pressures on pharmaceutical manufacturers, including us. In addition, wholesaler purchases may exceed customer demand, resulting in reduced

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wholesaler purchases in later quarters. We cannot assure you that wholesaler purchases will not decrease as a result of this potential excess buying.

Our future success depends upon our ability to develop new products, and new indications for existing products, that achieve market acceptance.

Our future performance will be affected by the market acceptance of products such as *Lumigan*®, *Alphagan*® *P, Restasis*®, *Zymar* and *Botox*®, as well as FDA approval of new indications for products such as *Botox*® and *Tazorac*®, and the oral formulation of *Tazorac*®. We have allocated substantial resources to the development and introduction of new products and indications. New products must be continually developed, tested and manufactured and, in addition, must meet regulatory standards and receive requisite regulatory approvals in a timely manner. Products that we are currently developing may or may not receive the regulatory approvals necessary for marketing. Furthermore, the development and commercialization process is time consuming, costly and subject to numerous factors that may delay or prevent the development and commercialization of new products, including legal actions brought by our competitors. In connection with our acquisitions of Bardeen Sciences Company, LLC and Oculex Pharmaceuticals, Inc., we acquired the right to continue researching and developing certain compounds and products, respectively, for commercialization. We cannot assure you that these or any other compounds or products that we are developing for commercialization will be able to be commercialized on terms that will be profitable or at all. If any of our products cannot be successfully or timely commercialized, our operating results could be materially adversely affected. Delays or unanticipated costs in any part of the process or our inability to obtain regulatory approval for our products, including failing to maintain manufacturing facilities in compliance with all applicable regulatory requirements, could cause our operating results to suffer. We cannot assure you that new products or indications will be successfully developed, receive regulatory approval or achieve market acceptance.

We may acquire companies in the future and these acquisitions could disrupt our business.

As part of our business strategy, we plan to consider, and as appropriate, make acquisitions of technologies, products and businesses, which may result in difficulties in integrating the technologies, products and businesses acquired and result in significant charges to earnings that may adversely affect our financial condition and stock price. We regularly review potential acquisitions of technologies, products and businesses complementary to our business. Acquisitions typically entail many risks and could result in difficulties in integrating the operations, personnel, technologies and products of the companies acquired. If we are unable to successfully integrate our acquisitions, we may not obtain the advantages that the acquisitions were intended to create, which may materially adversely affect our business, results of operations, financial condition and cash flows, our ability to develop and introduce new products and the market price of our stock. In connection with acquisitions, we could experience disruption in our business or employee base, or key employees of companies that we acquire may seek employment elsewhere, including with our competitors. Furthermore, our products or those of our customers and the products of companies we acquire may overlap, creating conflicts with existing relationships or with other commitments that are detrimental to the integrated businesses.

Compliance with the extensive government regulations to which we are subject is expensive and time consuming, and may result in the delay or cancellation of product sales, introductions or modifications.

Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development and manufacturing capabilities. All pharmaceutical companies, including Allergan, are subject to extensive, complex, costly and evolving regulation by the federal government, principally by the FDA and to a lesser extent by the U.S. Drug Enforcement Administration, and foreign and state government agencies. The Federal Food, Drug, and Cosmetic Act, the Controlled Substances Act and other domestic and foreign statutes and regulations govern or influence the testing, manufacturing, packing, labeling, storing, record keeping, safety, approval, advertising, promotion, sale and distribution of our products. Under certain of these regulations, we are subject to periodic inspection of our facilities, procedures and operations and/or the testing of our products by the FDA, the Drug Enforcement Agency and other

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authorities, which conduct periodic inspections to confirm that we are in compliance with all applicable regulations. In addition, the FDA conducts pre-approval and post-approval reviews and plant inspections to determine whether our systems and processes are in compliance with good manufacturing practices and other FDA regulations. The process for obtaining governmental approval to manufacture pharmaceutical products is rigorous, time-consuming and costly, and we cannot predict the extent to which we may be affected by legislative and regulatory developments. We are dependent on receiving FDA and other governmental approvals prior to manufacturing, marketing and shipping our products. Consequently, there is always a risk that the FDA or other applicable governmental authorities will not approve our products, or will take post-approval action limiting or revoking our ability to sell our products, or that the rate, timing and cost of such approvals will adversely affect our product introduction plans or results of operations.

Item 2. ***Properties***

Our operations are conducted in owned and leased facilities located throughout the world. We believe our present facilities are adequate for our current needs. Our headquarters and primary administrative and research facilities, which we own, are located in Irvine, California. We have two additional facilities located in California. One such facility is leased to provide raw material support and the other facility is leased to provide administrative support. We own one facility in Texas for manufacturing and warehousing.

Outside of the United States, we own and operate two facilities for manufacturing and warehousing. One such facility is located in Brazil and the other facility is located in Ireland. Other material facilities include one leased facility for administration and warehousing in Mexico; leased facilities for administration, warehousing and research and development in Japan; leased facilities for administration in Australia, Brazil, Canada, Germany, Hong Kong, Ireland, Italy, Spain and the United Kingdom; and leased facilities for administration and research and development in France.

Item 3. ***Legal Proceedings***

We are involved in various lawsuits and claims arising in the ordinary course of business.

On June 6, 2001, after receiving paragraph 4 invalidity and noninfringement Hatch-Waxman Act certifications from Apotex indicating that Apotex had filed an Abbreviated New Drug Application with the FDA for a generic form of *Acular*®, we and Syntex, the holder of the *Acular*® patent, filed a lawsuit entitled Syntex (U.S.A.) LLC and Allergan, Inc. v. Apotex, Inc., et al. in the United States District Court for the Northern District of California. On December 29, 2003, after a trial in June 2003, the court entered Findings of Fact and Conclusions of Law in favor of Allergan, thereby holding that the patent at issue is valid, enforceable and infringed by Apotex s proposed generic drug. On January 27, 2004, the court entered final judgment in our favor. We have also filed a separate lawsuit in Canada against Apotex similarly relating to a generic version of *Acular*®.

On January 9, 2002, we filed a patent infringement lawsuit in the United States District Court for the Central District of California entitled Allergan, Inc., et al. v. Alcon Laboratories, Inc., et al. and Bausch & Lomb Incorporated. We filed the complaint after Alcon and Bausch & Lomb challenged certain patents covering *Alphagan*® and after Alcon and Bausch & Lomb filed Abbreviated New Drug Applications with the FDA for a generic version of *Alphagan*®. In our complaint, we asked the court to find that the *Alphagan*® patents at issue are valid and infringed by the drug products sought to be approved in the Alcon and Bausch & Lomb Abbreviated New Drug Applications. On April 1, 2002, Alcon filed a motion for summary judgment that the court granted on May 8, 2002. Also on May 8, 2002, Bausch & Lomb filed a motion for summary judgment that the court granted on June 4, 2002. On July 12, 2002, we filed an expedited appeal with the United States Court of Appeals for the Federal Circuit seeking to overturn those rulings. On October 11, 2002, the United States Court of Appeals for the Federal Circuit heard oral argument on our appeal. On March 28, 2003, the United States Court of Appeals for the Federal Circuit affirmed the decision of the district court granting summary judgment in favor of Alcon and Bausch and Lomb. On April 7, 2003, we filed a Petition for Rehearing En Banc with the United States Court of Appeals for the Federal Circuit. On May 22, 2003, the United States Court of Appeals for the Federal Circuit denied our Petition for Rehearing En Banc. On

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September 19, 2003, we filed a Petition for Writ of Certiorari with the United States Supreme Court. On December 1, 2003, the United States Supreme Court denied our Petition for Writ of Certiorari.

On January 23, 2003, a complaint entitled Irena Medavoy and Morris Mike Medavoy v. Arnold W. Klein, M.D., et al. and Allergan, Inc. was filed in the Superior Court of the State of California for the County of Los Angeles. The complaint contained, among other things, allegations against us of negligence, unfair business practices, product liability, intentional misconduct, fraud, negligent misrepresentation, strict liability in tort, improper off-label promotion and loss of consortium. The complaint also contained separate allegations against the other defendants. We were served with the complaint on February 25, 2003. On April 10, 2003, Morris Mike Medavoy voluntarily served on us a Request for Dismissal Without Prejudice for the only two causes of action he asserted in the complaint. The causes of action asserted by Irena Medavoy against us were not affected by this Request for Dismissal. On July 8, 2003, Irena Medavoy filed a First Amended Complaint, adding allegations of false and/or misleading advertising and unjust enrichment, as well as false and/or misleading advertising and unfair competition. On August 12, 2003, we filed a demurrer to the First Amended Complaint. Oral argument on our demurrer was heard on November 7, 2003, at which time the court sustained our demurrer without leave to amend as to two causes of action and denied our demurrer as to the remaining ten causes of action. On December 8, 2003, the court set a trial date to commence on April 28, 2004.

On May 19, 2003, we were informed by the Federal Trade Commission s Bureau of Competition (FTC) that the FTC was conducting a non-public investigation to determine whether we, Syntex or any other person is engaging in unfair competition by monopolizing or attempting to monopolize the market for ketorolac tromethamine ophthalmic solution by preventing or slowing generic competition to *Acular*®, or by otherwise restraining competition to *Acular*®. On February 9, 2004, the FTC informed us that it had closed the investigation.

On July 1, 2003, a complaint entitled Apotex, Inc., Apotex Corp. and Novex Pharma Inc. v. Roche Palo Alto, LLC and Allergan, Inc. was filed in the United States District Court for the Northern District of California. The complaint contains, among other things, allegations against us for monopolization, conspiracy to monopolize and unfair competition relating to our ketorolac ophthalmic solutions in the United States marketplace. We were served with the complaint on July 17, 2003. On January 7, 2004, Apotex, Inc., Apotex Corp. and Novex Pharma Inc. filed a Notice of Dismissal without Prejudice with the court, thereby dismissing the action.

Because of the uncertainties related to the incurrence, amount and range of loss on any pending litigation, investigation or claim, management is currently unable to predict the ultimate outcome of any litigation, investigation or claim, determine whether a liability has been incurred or make a reasonable estimate of the liability that could result from an unfavorable outcome. We believe, however, that the liability, if any, resulting from the aggregate amount of uninsured damages for any outstanding litigation, investigation or claim will not have a material adverse effect on our consolidated financial position, liquidity or results of operations. However, an adverse ruling in a patent infringement lawsuit involving us could materially affect our ability to sell one or more of our products or could result in additional competition. In view of the unpredictable nature of such matters, we cannot provide any assurances regarding the outcome of any litigation, investigation or claim to which we are a party or the impact on us of an adverse ruling in such matters.

Item 4. ***Submission of Matters to a Vote of Security Holders***

We did not submit any matter during the fourth quarter of the fiscal year covered by this report to a vote of security holders, through the solicitation of proxies or otherwise.

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PART II

Item 5. ***Market For Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

The following table shows the quarterly price range of our common stock and the cash dividends declared per share of common stock during the periods listed.

	2003			2002(1)		
Calendar Quarter	Low	High	Div.	Low	High	Div.
First	$56.60	$71.53	$0.09	$58.58	$72.35	$0.09
Second	66.81	81.55	0.09	54.01	67.23	0.09
Third	75.82	81.80	0.09	49.05	65.49	0.09
Fourth	71.65	81.48	0.09	51.40	65.08	0.09

(1) On June 29, 2002, we distributed to our stockholders, in the form of a stock dividend, one share of our then wholly-owned subsidiary, Advanced Medical Optics, Inc., for every 4.5 shares of our common stock held on June 14, 2002. The 2002 stock prices presented above are restated stock prices and reflect the distribution of our ownership in Advanced Medical Optics to our stockholders.

Our common stock is listed on the New York Stock Exchange and is traded under the symbol AGN. In newspapers, stock information is frequently listed as Alergn.

The approximate number of stockholders of record was 6,700 as of January 30, 2004.

On January 27, 2004, our board of directors declared a cash dividend of $0.09 per share, payable March 18, 2004 to stockholders of record on February 18, 2004. See Note 7, Notes Payable and Long-Term Debt, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report for further information concerning restrictions on dividend payments.

Recent Sales of Unregistered Securities

On April 3, 2003, we issued $34,875,000 in principal aggregate amount of 3.560% Notes due 2008 (the Notes) to J.P. Morgan Securities Inc., as initial purchaser. The Notes were issued to J.P. Morgan Securities concurrent with and in exchange for the repurchase and cancellation by J.P. Morgan Securities of all of our outstanding 6.22% Dealer Remarketable Securities due 2013 (the Dealer Remarketable Securities) issued in the initial aggregate amount of $30,000,000. Because the Notes were issued in exchange for the cancellation and delivery of the Dealer Remarketable Securities, we did not receive any proceeds from the issuance of the Notes. The Notes were issued with terms that are not substantially different from the terms of the Dealer Remarketable Securities. The Notes were offered and sold in a private placement in compliance with Rule 144A under the Securities Act of 1933.

The Notes, which will mature on April 3, 2008, are general unsecured obligations ranking equally with all of our other unsecured senior indebtedness and senior in right of payment to any subordinated indebtedness. The Notes are effectively subordinated to all indebtedness and liabilities of our subsidiaries.

Securities Authorized for Issuance Under Equity Compensation Plans

The information included under Item 12 of Part III of this report is hereby incorporated by reference into this Item 5 of Part II of this report.

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Issuer Purchases of Equity Securities

The following table discloses the purchases of our equity securities during the fourth fiscal quarter of 2003.

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs(2)
September 27, 2003 to October 31, 2003	100,000	$77.2557	100,000	5,580,623
November 1, 2003 to November 30, 2003	489,900	$74.8301	489,900	5,142,830
December 1, 2003 to December 31, 2003	100,000	$73.6713	100,000	5,088,209
Total	689,900	$75.0137	689,900	N/A

(1) The Company maintains an evergreen stock repurchase program, which was first announced on September 28, 1993. Under the stock repurchase program, the Company may maintain up to 9.2 million repurchased shares in its treasury account at any one time. As of December 31, 2003, the Company held approximately 4.1 million treasury shares under this program.

(2) The following share numbers reflect the maximum number of shares that may be purchased under the Company s stock repurchase program and are as of the end of each of the respective periods.

Item 6. ***Selected Financial Data***

SELECTED CONSOLIDATED FINANCIAL DATA

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in millions, except per share data)				
Summary of Operations					
Product net sales	$1,755.4	$1,385.0	$1,142.1	$992.1	$828.6
Research service revenues (primarily from a related party through April 16, 2001)	16.0	40.3	60.3	62.9	46.2
Operating costs and expenses:					
Cost of product sales	320.3	221.7	198.1	197.7	170.4
Cost of research services	14.5	36.6	56.1	59.4	43.3
Selling, general and administrative	693.6	629.5	481.1	409.2	332.2
Research and development	763.5	233.1	227.5	165.7	140.6
Technology fees from related party			(0.7)	(3.1)	(6.1)
Legal settlement		118.7			
Restructuring charge (reversal) and asset write-offs, net	(0.4)	62.4	(1.7)	0.2	(4.4)
Operating income (loss)	(20.1)	123.3	242.0	225.9	198.8
Non-operating income (loss)	(9.4)	(33.5)	18.3	9.7	12.4
Earnings (loss) from continuing operations before income taxes and minority interest	(29.5)	89.8	260.3	235.6	211.2
Earnings (loss) from continuing operations	(52.5)	64.0	171.2	165.9	143.7
Earnings from discontinued operations		11.2	54.9	49.2	44.5

Net earnings (loss)	(52.5)	75.2	224.9	215.1	188.2

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SELECTED CONSOLIDATED FINANCIAL DATA (Continued)

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in millions, except per share data)				
Summary of Operations (continued)					
Basic earnings (loss) per share:					
Continuing operations	$ (0.40)	$ 0.49	$ 1.30	$ 1.27	$ 1.09
Discontinued operations		0.09	0.42	0.38	0.33
Diluted earnings (loss) per share:					
Continuing operations	$ (0.40)	$ 0.49	$ 1.29	$ 1.24	$ 1.06
Discontinued operations		0.08	0.40	0.37	0.33
Cash dividends per share	0.36	0.36	0.36	0.32	0.28
Financial Position					
Current assets	$ 928.2	$1,200.2	$1,114.8	$1,097.4	$ 697.5
Working capital	544.8	796.6	710.4	752.1	277.6
Total assets	1,754.9	1,806.6	2,046.2	1,971.0	1,339.1
Long-term debt	573.3	526.4	444.8	484.3	208.8
Total stockholders equity	718.6	808.3	977.4	873.8	634.5

The financial data above has been recast to reflect the results of operations and financial positions of our ophthalmic, surgical and contact lens care businesses as a discontinued operation. The results of operations for our discontinued operations includes allocations of certain Allergan expenses to those operations. These amounts have been allocated on the basis that is considered to reflect most fairly or reasonably the utilization of the services provided to, or the benefit obtained by, those operations.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

This financial review presents our operating results for each of the three years in the period ended December 31, 2003, and our financial condition at December 31, 2003. Except for the historical information contained herein, the following discussion contains forward-looking statements which are subject to known and unknown risks, uncertainties and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements. We discuss such risks, uncertainties and other factors throughout this report and specifically under the caption Certain Factors and Trends Affecting Allergan and its Businesses in Item 1 of Part I of this report. In addition, the following review should be read in connection with the information presented in our consolidated financial statements and the related notes to our consolidated financial statements.

Critical Accounting Policies

We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our consolidated financial statements, so we consider these to be our critical accounting policies. Because of the uncertainty inherent in these matters, actual results could differ from the estimates we use in applying the critical accounting policies.

Revenue Recognition

We recognize revenue from product sales when goods are shipped and title and risk of loss transfer to the customer. We generally offer cash discounts to customers for the early payment of receivables. Those discounts are recorded as a reduction of revenue and accounts receivable in the same period that the related sale is recorded. The amount reserved for cash discounts was $1.2 million at December 31, 2003 and 2002. We permit returns of product from any product line by any class of customer if such product is returned in a timely

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manner, in good condition and from the normal channels of distribution. Return policies in certain international markets provide for more stringent guidelines in accordance with the terms of contractual agreements with customers. Allowances for returns are provided for based upon an analysis of our historical patterns of returns matched against the sales from which they originated. The amount of allowances for sales returns reserved at December 31, 2003 and 2002 were $6.3 million and $5.4 million, respectively. Additionally, we participate in various managed care sales rebate and other incentive programs, the largest of which relates to Medicaid. Sales rebate and incentive accruals reduce revenue in the same period that the related sale is recorded and are included in Other accrued expenses in our consolidated balance sheets. The accruals for sales rebates and other incentive programs are based on estimates of the proportion of sales that are subject to such rebates and incentive programs. The amounts accrued for sales rebates and other incentive programs at December 31, 2003 and 2002 were $49.5 million and $38.3 million, respectively.

Historical allowances for cash discounts, product returns and rebates and incentives have been within the amounts reserved or accrued, respectively. However, material differences may result in the amount of revenue we recognize from product sales if the actual amount of product returns and the amount of rebates and incentives differ materially from the amounts estimated by management.

Pensions

We sponsor various pension plans in the U.S. and abroad in accordance with local laws and regulations. In connection with these plans, we use certain actuarial assumptions to determine the plans net periodic benefit costs and projected benefit obligations, the most significant of which are the expected long-term rate of return on assets and the discount rate.

Our assumption for the expected long-term rate of return on assets in our U.S. pension plan to determine the net periodic benefit cost is 8.25% for 2003, which represents a 1.25% decline from our 2002 expected rate of return of 9.50%. We determine, based upon recommendations from our pension plans investment advisors, the expected rate of return using a building block approach that considers diversification and rebalancing for a long-term portfolio of invested assets. Our investment advisors study historical market returns and preserve long-term historical relationships between equities and fixed income in a manner consistent with the widely-accepted capital market principle that assets with higher volatility generate a greater return over the long run. They also evaluate market factors such as inflation and interest rates before long-term capital market assumptions are determined. The expected rate of return is applied to the market-related value of plan assets. As a sensitivity measure, the effect of a 0.25% decline in the return on assets assumption would increase our expected 2004 U.S. pre-tax pension benefit cost by approximately $0.6 million.

The discount rate used to calculate our U.S. pension benefit obligations at December 31, 2003 is 6.10%, which represents a 0.65% decline from our December 31, 2002 rate of 6.75%. We determine the discount rate largely based upon an index of high-quality fixed income investments (U.S. Moody s Aa Corporate Long Bond Yield Average) at the plans measurement date. As a sensitivity measure, the effect of a 0.25% decline in the discount rate assumption would increase our expected 2004 U.S. pre-tax pension benefit costs by approximately $1.4 million and increase our U.S. pension plans projected benefit obligations at December 31, 2003 by approximately $11 million.

Income Taxes

Income taxes are determined using an annual effective tax rate, which is generally less than the U.S. Federal statutory rate, primarily because of lower tax rates in certain non-U.S. jurisdictions and R&D tax credits available in the United States. Our effective tax rate may be subject to fluctuations during the fiscal year as new information is obtained which may affect the assumptions we use to estimate our annual effective tax rate, including factors such as our mix of pre-tax earnings in the various tax jurisdictions in which we operate, valuation allowances against deferred tax assets, reserves for tax audit issues and settlements, utilization of R&D tax credits and changes in tax laws in jurisdictions where we conduct operations. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. We record valuation allowances against our deferred tax assets to

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reduce the net carrying value to an amount that management believes is more likely than not to be realized. When we establish or reduce the valuation allowance against our deferred tax assets, our income tax expense will increase or decrease, respectively, in the period such determination is made. Valuation allowances against our deferred tax assets were $62.6 million and $73.9 million at December 31, 2003 and 2002, respectively. Material differences may result in an increase or decrease in the provision for income taxes if the actual amounts for valuation allowances required against deferred tax assets differ from the amounts estimated by us. Withholding and U.S. taxes have not been provided for the unremitted earnings of certain non-U.S. subsidiaries because we have reinvested or expect to reinvest these earnings permanently in such operations. At December 31, 2003, we had approximately $712 million in unremitted earnings outside the United States for which withholding and U.S. taxes were not provided. Tax expense would be incurred if these funds were remitted to the United States. It is not practicable to estimate the amount of the deferred tax liability on such unremitted earnings. Upon remittance, certain foreign countries impose withholding taxes that are then available, subject to certain limitations, for use as credits against our U.S. tax liability, if any.

Purchase Price Allocation

The allocation of purchase price for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the identifiable tangible and intangible assets acquired, including in-process research and development, and liabilities assumed based on their respective fair values. Additionally, we must determine whether an acquired entity is considered to be a business or a set of net assets, because a portion of the purchase price can only be allocated to goodwill in a business combination.

The aggregate purchase price for Oculex Pharmaceuticals, Inc. (Oculex) and Bardeen Sciences Company, LLC (Bardeen) of approximately $223.8 million and $264.6 million, respectively, was allocated to identified assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. Oculex was determined to be a business combination, while Bardeen was considered to be an asset acquisition and not a business combination. Accordingly, we have provided *pro forma* financial information in our financial statements to reflect the effect of the Oculex acquisition on our historical operating results, but have not done so for the Bardeen acquisition. See Note 4, Acquisitions, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report.

We determined that the assets acquired from Oculex and Bardeen consisted principally of incomplete in-process research and development and that these projects had no alternative future uses in their current state. We reached this conclusion based on discussions with our business development and research and development personnel, our review of long-range product plans and our review of a valuation report prepared by an independent valuation specialist. The valuation specialist s report reached a conclusion with regard to the fair value of the in-process research and development assets in a manner consistent with principles prescribed in the AICPA practice aid, *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices and Pharmaceutical Industries*. In connection with the acquisition of Oculex, we determined that the assets acquired also included a proprietary technology drug delivery platform which was separately valued and capitalized as core technology. We reached this conclusion based on our determination that the acquired technology had alternative future uses in its current state.

We consulted with our independent auditor in arriving at the determination to record a charge to in-process research and development expense and to capitalize core technology. We believe the fair values assigned to the assets acquired and liabilities assumed are based on reasonable assumptions.

Discontinued Operations

On June 29, 2002, we completed the spin-off of our optical medical device business to our stockholders. The optical medical device business consisted of two businesses: our ophthalmic surgical products business, which developed, manufactured and marketed products that included artificial lenses for the eye, called intraocular lenses, and equipment for cataract and refractive eye surgery; and our contact lens care products business, which developed, manufactured and marketed a broad range of products for use with every available type of contact lens. The spin-off was effected by contributing our optical medical device business to a newly

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formed subsidiary, Advanced Medical Optics, Inc., and issuing a dividend of Advanced Medical Optics common stock to our stockholders. The common stock of Advanced Medical Optics began trading publicly on the New York Stock Exchange on July 1, 2002 under the symbol AVO. As a result of the spin-off, we continue to own and operate our specialty pharmaceutical business, and Advanced Medical Optics owns and operates what was formerly our optical medical device business. We have no ownership interest in Advanced Medical Optics. Our consolidated financial statements and related notes contained herein have been recast to reflect the financial position, results of operations and cash flows of Advanced Medical Optics as a discontinued operation.

We did not account for our ophthalmic surgical and contact lens care businesses as a separate legal entity. Therefore, the following selected financial data for our discontinued operations is presented for informational purposes only and does not necessarily reflect what the net sales or earnings would have been had the businesses operated as a stand-alone entity. The financial information for our discontinued operations includes allocations of certain of our expenses to those operations. These amounts have been allocated to our discontinued operations on the basis that is considered by management to reflect most fairly or reasonably the utilization of the services provided to, or the benefit obtained by, those operations. See Note 2, Discontinued Operations, in the notes to the consolidated financial statements listed under Item 15(a) of Part IV of this report.

Effective with the third quarter of our 2002 fiscal year, we no longer include the results of operations and cash flows of our discontinued optical medical device business in our consolidated financial statements.

The following table sets forth selected financial data of our discontinued operations.

Selected Financial Data for Discontinued Operations

	Year Ended December 31,		
	2003	2002	2001
		(in millions)	
Net sales	$	$251.7	$543.1
Earnings from discontinued operations, net of tax		11.2	54.9

Through the end of 2002, actual costs incurred by us related to the spin-off of Advanced Medical Optics, including restructuring and duplicate operating expenses, were approximately $104.7 million, including $4.4 million of costs incurred prior to 2002. This amount excludes $14.3 million in costs incurred in 2002 that were allocated to discontinued operations. During 2003, we reversed approximately $0.4 million of our restructuring charge related to the spin-off of Advanced Medical Optics due to adjustments to certain estimated amounts. Through the end of 2003, we also paid $18.7 million for various taxes, net of amounts associated with a tax sharing agreement with Advanced Medical Optics, related to intercompany purchases of assets by Advanced Medical Optics prior to the spin-off that were deferred and charged to retained earnings as part of the dividend of Advanced Medical Optics stock to our stockholders.

Additionally, we believe we have incurred approximately $15 million to $20 million of additional annual net costs associated with dissynergies, contract manufacturing arrangements and changes to cost and debt capital structure as a result of the separation of Advanced Medical Optics from us. We began to incur these additional costs during the second half of 2002, and they are not reflected in our results of continuing operations for the first half of 2002. Our manufacturing and supply agreement with Advanced Medical Optics is scheduled to terminate on June 28, 2005, at which time we could possibly incur between $30 million and $40 million of additional restructuring costs associated with the completion of that agreement and expected exit activities.

Continuing Operations

Headquartered in Irvine, California, we are a technology-driven, global health care company that develops and commercializes specialty pharmaceutical products for the ophthalmic, neurological, dermatological and other specialty markets. We employ approximately 4,930 persons around the world. We are an

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innovative leader in therapeutic and over-the-counter products that are sold in more than 100 countries. Our principal markets are the United States, Europe, Latin America and Asia Pacific.

Results of Continuing Operations

We operate our business on the basis of a single reportable segment specialty pharmaceuticals. We produce a broad range of ophthalmic products for glaucoma therapy, ocular inflammation, infection, allergy and dry eye; skin care products for acne, psoriasis and other prescription and over-the-counter dermatological products; and *Botox*® for certain therapeutic and cosmetic indications. We provide global marketing strategy teams to ensure development and execution of a consistent marketing strategy for our products in all geographic regions that share similar distribution channels and customers. The following discussion reflects our results of continuing operations, unless otherwise indicated.

Management evaluates its various product portfolios on a revenue basis, which is presented below. We also report sales performance using the non-GAAP financial measure of constant currency sales. Constant currency sales represent current period reported sales, adjusted for the translation effect of changes in average foreign exchange rates between the current period and the corresponding period in the prior year. We calculate the currency effect by comparing adjusted current period reported amounts, calculated using the monthly average foreign exchange rates for the corresponding period in the prior year, to the actual current period reported amounts. We routinely evaluate our net sales performance at constant currency so that sales results can be viewed without the impact of changing foreign currency exchange rates, thereby facilitating period-to-period comparisons of our sales. Generally, when the U.S. dollar either strengthens or weakens against other currencies, the growth at constant currency rates will be higher or lower, respectively, than growth reported at actual exchange rates.

The following tables compare net sales by product line and certain selected products for the years ended December 31, 2003, 2002 and 2001:

	Year Ended December 31,		Change in Net Sales			Percent Change in Net Sales		
	2003	2002	Total	Performance	Currency	Total	Performance	Currency
			(in millions)					
Net Sales by Product Line:								
Eye Care Pharmaceuticals	$ 999.5	$ 827.3	$172.2	$142.1	$30.1	20.8%	17.2%	3.6%
Botox/ Neuromodulator	563.9	439.7	124.2	108.8	15.4	28.2%	24.7%	3.5%
Skin Care	109.3	90.2	19.1	18.8	0.3	21.2%	20.8%	0.4%
Total	1,672.7	1,357.2	315.5	269.7	45.8	23.2%	19.9%	3.3%
Other*	82.7	27.8	54.9	54.8	0.1	197.5%	197.1%	0.4%
Total net sales	$1,755.4	$1,385.0	$370.4	$324.5	$45.9	26.7%	23.4%	3.3%
Domestic	70.4%	70.6%						
International	29.6%	29.4%						
Selected Product Sales:								
Alphagan P and Alphagan	$ 286.8	$ 248.5	$ 38.3	$ 30.4	$ 7.9	15.4%	12.2%	3.2%
Lumigan	181.3	123.0	58.3	51.8	6.5	47.4%	42.1%	5.3%
Other Glaucoma	22.7	24.6	(1.9)	(3.6)	1.7	(7.7)%		