ALLERGAN INC
Form 10-K405
March 01, 2002

Table of Contents

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended December 31, 2001

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
Irvine, California
(Address of principal executive offices) **92612**
(Zip Code)

Registrant s telephone number: (714) 246-4500

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 No

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

The aggregate market value of the registrant s voting stock held by non-affiliates was approximately $9,234,705,186 on January 25, 2002, based upon the closing price on the New York Stock Exchange on such date.

Common Stock outstanding as of January 25, 2002 134,254,772 shares (including 3,370,092 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 24, 2002, which proxy statement will be filed no later than 120 days after the close of the registrant s fiscal year ended December 31, 2001.

TABLE OF CONTENTS

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

ITEM 1. BUSINESS

General Development of Business

Allergan, Inc. (Allergan or the Company) is a technology-driven, global health care company that develops and commercializes specialty pharmaceutical products for the ophthalmic, neurological, dermatological and other specialty markets as well as ophthalmic surgical devices and contact lens care solutions. Its worldwide consolidated revenues are principally generated by prescription and non-prescription pharmaceutical products in the areas of ophthalmology and skin care, neurotoxins, intraocular lenses and other ophthalmic surgical products, and contact lens care products.

Allergan was originally incorporated in California in 1948, became known as Allergan Corporation in 1950, and reincorporated in Delaware in 1977. In 1980, the Company was acquired by SmithKline Beecham plc (then known as SmithKline Corporation and herein SmithKline). The Company operated as a wholly-owned subsidiary of SmithKline from 1980 until 1989 when Allergan again became a stand-alone public company through a spin-off distribution by SmithKline.

On January 18, 2002, the Company s board of directors approved the separation of the Company s pharmaceutical and optical medical device businesses into two independent companies through a spin-off distribution of the Company s ophthalmic surgical and contact lens care businesses. The spin-off is expected to occur at mid-year 2002. After the spin-off, Allergan will be a specialty pharmaceutical company with businesses in ophthalmic, dermatological and neuromuscular/neurotoxin pharmaceuticals.

The new entity, to be called Advanced Medical Optics, Inc. (AMO), will be established as an independent, publicly traded company serving the optical medical device markets, including the contact lens care and ophthalmic surgical businesses. The spin-off of AMO will be effected through a pro rata distribution to Allergan s stockholders of shares of a newly formed holding company. AMO intends to apply for a listing with the New York Stock Exchange.

The spin-off transaction, which is intended to be tax-free to Allergan s stockholders, is subject to a number of conditions, including the receipt of a favorable ruling from the Internal Revenue Service, the receipt of required regulatory approvals, market conditions and final approvals by Allergan s board of directors. Allergan contemplates that AMO will raise approximately $275 million in debt financing at or around the time of the spin-off that will be utilized to repay certain intercompany and Allergan third party debt.

Table of Contents

Allergan Businesses

The following table sets forth, for the periods indicated, the net sales from continuing operations for each of the Company s specialty therapeutics businesses and product lines:

	Year Ended December 31		
	2001	2000	1999
		(in millions)	
Specialty Pharmaceuticals:			
Eye Care Pharmaceuticals	$745.8	$675.3	$571.2
Skin Care	78.9	68.7	76.6
Botox®/Neuromuscular	309.5	239.5	175.8
Total	1,134.2	983.5	823.6
Optical Medical Devices:			
Ophthalmic Surgical	253.9	250.4	222.9
Contact Lens Care	297.1	328.7	359.7
Total	551.0	579.1	582.6
Total Product Net Sales	$1,685.2	$1,562.6	$1,406.2

Domestic		
55.4%	51.7%	48.1%
International		
44.6%	48.3%	51.9%

See Note 16 of Notes to Consolidated Financial Statements for further information concerning foreign and domestic operations.

Specialty Pharmaceutical Business

Eye Care Pharmaceutical Product Line

Allergan develops, manufactures and markets a broad range of prescription and non-prescription products designed to treat diseases and disorders of the eye, including glaucoma, inflammation, infection and allergy. In addition, Allergan s specialty product line consists of products designed to treat ocular surface disease, including artificial tears and ocular decongestants. Allergan will continue to develop, manufacture and market prescription and non-prescription products designed to treat diseases and disorders of the eye after completion of the spin-off transaction described above.

Glaucoma

The largest segment of the market for ophthalmic prescription drugs is for the treatment of glaucoma, a sight-threatening disease characterized by elevated intraocular pressure (IOP) leading to optic nerve damage. Allergan s largest selling eye care pharmaceutical product is *Alphagan*® ophthalmic solution, which was approved by the United States Food and Drug Administration (FDA) in September 1996 for the treatment of open-angle glaucoma and ocular hypertension. Combined sales of *Alphagan*® and *Alphagan*® *P* ophthalmic solution, which is described below and which was introduced in 2001, represented 15% of total Company sales in 2001, and sales of *Alphagan*® represented 15% and 12% of total Company sales in 2000 and 1999, respectively. The period of new chemical entity exclusivity in the United States for *Alphagan*® ophthalmic solution ended in September 2001. Allergan received a six month exclusivity extension from the FDA for the pediatric use of *Alphagan*®, which will expire in March 2002. Allergan has filed a patent infringement lawsuit against Alcon Laboratories, Inc. (a division of Nestlé) and Bausch & Lomb, both of which have challenged certain patents covering *Alphagan*® and, based on those challenges, have filed an Abbreviated New Drug Application (ANDA) with the FDA for a generic version of *Alphagan*®. See Item 3, Legal Proceedings, at page 13 and Note 15, Commitments and Contingencies, in the Notes to Consolidated Financial Statements. Allergan sells *Alphagan*® ophthalmic solution in 59 countries worldwide.

Table of Contents

In March 2001, the FDA approved *Lumigan*®, a topical treatment indicated for the reduction of elevated IOP in patients with glaucoma or ocular hypertension who are either intolerant or insufficiently responsive when treated with other IOP-lowering medications. The Company is engaged in litigation with Pharmacia Corporation regarding certain patents owned or controlled by Pharmacia, which Pharmacia contends cover *Lumigan*®. See Item 3, Legal Proceedings, at page 13 and Note 15, Commitments and Contingencies, in the Notes to Consolidated Financial Statements. In November 2001, the Committee for Proprietary Medicinal Products recommended that *Lumigan*® be approved by the European Commission for use in certain European countries. In addition, *Lumigan*® has received approval in six Latin American countries.

In March 2001, the FDA approved *Alphagan*® *P*, a reformulation of *Alphagan*® containing brimonidine, *Alphagan*® s active ingredient, preserved with *Purite*® for the lowering of IOP in patients with open-angle glaucoma and ocular hypertension. *Alphagan*® *P* lowers IOP by reducing aqueous humor production and increasing uveoscleral outflow, while data suggests that *Lumigan*® lowers IOP by increasing the outflow of aqueous humor through trabecular meshwork and uveoscleral routes. In December 2001, Allergan signed a global license agreement with Laboratoires Thea S.A. for the use of its *ABAK*™ device, a multi-dose system for the delivery of preservative-free eye drops. Initially, the *ABAK*™ system will be used for *Alphagan*® in Europe, and later, possibly *Lumigan*®.

In September 2001, the Company filed a New Drug Application (NDA) with the FDA for a brimonidine and timolol combination designed to treat glaucoma.

The Company also markets *Betagan*® ophthalmic solution, a topical beta blocker used in the treatment of glaucoma, and *Propine*® ophthalmic solution, which is used alone or in combination with other drugs when initial drug therapy for glaucoma becomes inadequate. Patent protection for both products expired in the United States in 1991 and they both face generic competition from several companies including Bausch & Lomb and Alcon Laboratories, Inc. In addition, the Company markets its own generic version of these two products.

Inflammation

Allergan s leading ophthalmic anti-inflammatory product is *Acular*®[1] ophthalmic solution. *Acular*® is indicated for the relief of itch associated with seasonal allergic conjunctivitis and for the treatment of post-operative inflammation in patients who have undergone cataract extraction. Allergan, along with Syntex, the holder of the patent, has filed a patent infringement lawsuit against Apotex, Inc., Apotex Corp. and Novex Pharma in the Northern District of California based on Apotex s challenge of certain patents covering *Acular*® and Apotex s filing of an Abbreviated New Drug Application (ANDA) for a generic version of *Acular*®. In addition, Allergan has filed a lawsuit in Canada against Apotex similarly relating to a generic version of *Acular*® in Canada. See Item 3, Legal Proceedings, at page 13 and Note 15, Commitments and Contingencies, in the Notes to Consolidated Financial Statements. *Acular*® *PF* was the first unit-dose, preservative-free topical non-steroidal anti-inflammatory drug in the United States, and is indicated for the reduction of ocular pain and photophobia following incisional refractive surgery. *Pred Forte*® and *FML*® *Liquifilm*® ophthalmic suspensions are Allergan s products in the ocular corticosteroid inflammation market. *Pred Forte*® no longer has patent protection and faces generic competition.

Infection

Allergan s major products in the anti-infective market are *Ocuflox*®/*Oflox*®/*Exocin*® ophthalmic solution, a fluroquinolone which treats bacterial conjunctivitis and corneal ulcers, *Blephamide*® ophthalmic suspension, a topical anti-inflammatory and anti-infective, and *Polytrim*® ophthalmic solution, a synthetic anti-microbial which treats surface ocular bacterial infections. *Blephamide*® and *Polytrim*® ophthalmic solutions no longer have patent protection and face generic competition. In December 2001, Allergan and McNeil Consumer Healthcare, a subsidiary of Johnson & Johnson, mutually agreed to terminate their commercial collaboration regarding the marketing of *Ocuflox*® in the United States pediatric market. Allergan has established a contract sales force to promote *Ocuflox*® to pediatricians in the United States.

[1] *Acular*® is a registered trademark of and is licensed from its developer Syntex (U.S.A.) Inc.

Table of Contents

Allergy

Allergan s allergy product is *Alocril*® ophthalmic solution. *Alocril*® is indicated for the treatment of itch associated with allergic conjunctivitis. The allergy market is, by its nature, a seasonal market, peaking during the spring months. Allergan has established a contract sales force to promote *Alocril*® to pediatricians in the United States.

Ocular Surface Disease

In addition to its eye care pharmaceuticals, Allergan markets a variety of artificial tear products for various needs, under a range of brand names worldwide, led by the *Refresh*® brand. In the United States, the *Refresh*® brand includes *Refresh Plus*®, *Refresh Tears*®, and *Refresh P.M.*® In May 2001, *Refresh LiquiGel*®, an over-the-counter lubricant eye drop treatment for sufferers of dry eye, was launched in the United States. Allergan also markets *Celluvisc*® in the United States for severe dry eye. Other Allergan brands marketed around the world include *Liquifilm Tears*® and *Lacri-Lube*® *S.O.P.*®, as well as *Lerin*®, a decongestant.

Allergan also provides an eye drop for contact lens wearers called *Refresh Contacts*® to help provide comfort and protection from dryness and irritation.

Allergan is conducting an additional Phase III study for *Restasis*™, a prescription ophthalmic emulsion product for the treatment of chronic dry eye disease. In June 2001, Allergan and Inspire Pharmaceuticals, Inc. entered into a licensing, development and marketing agreement under which Allergan obtained an exclusive license to develop and commercialize Inspire s INS365 Ophthalmic, a product in Phase III clinical trials for its ability to relieve the signs and symptoms of dry eye disease and which Allergan believes complements *Restasis*™. In January 2002, Inspire announced that preliminary results from the first of two Phase III clinical trials for INS365 Ophthalmic indicated that INS365 Ophthalmic did not meet the primary efficacy objectives of the study, but that Inspire would continue to extensively analyze the results, including the higher than expected placebo effect found in the preliminary results.

Skin Care Product Line

Allergan s skin care business is currently comprised of three main product lines: tazarotene products in cream and gel formulations marketed under *Tazorac*® in the United States and Canada and as *Zorac*® elsewhere; *Azelex*®, an acne product; and the *M.D. Forte*® line of alpha hydroxy acid products. Allergan promotes its skin care products primarily in the United States. Allergan will continue to develop, manufacture and market skin care products after completion of the spin-off transaction described above.

In June 1997, the Company received approval from the FDA to market *Tazorac*® gel for the treatment of plaque psoriasis and acne. The FDA approved the cream formulation of *Tazorac*® in October 2000 for the treatment of psoriasis. In September 2001, Allergan received FDA approval to market *Tazorac*® cream for the topical treatment of acne vulgaris. In July 2001, Allergan entered into a co-promotion agreement for *Tazorac*® with Procter & Gamble Pharmaceuticals Inc. for the United States. Procter & Gamble Pharmaceuticals will market *Tazorac*® primarily to the general practitioner market. Allergan will continue to market *Tazorac*® to dermatologists currently covered by its in-house sales force. Allergan has engaged Pierre Fabre Dermatologie and Bioglan Pharma PLC as its promotion partners for *Zorac*® in Europe, the Middle East and Africa.

In June 2001, Allergan filed a NDA with the FDA for a tazarotene cream formulation in the treatment of the signs and symptoms of photodamage, including fine wrinkles and discoloration of skin that can result from sun exposure.

Azelex® cream is approved for the topical treatment of mild to moderate inflammatory acne vulgaris. Allergan launched *Azelex*® cream in the U.S. in December 1995.

The Company also develops and markets glycolic acid-based skin care products. The Company s *M.D. Forte*® line of alpha hydroxy acid products are marketed to and dispensed by physicians.

Table of Contents

Botox®

Allergan s *Botox*® (Botulinum Toxin Type A) is used in the treatment of certain neuromuscular disorders which are characterized by involuntary muscle contractions or spasms. Sales of *Botox*® represented approximately 18%, 15% and 13% of total Company sales in 2001, 2000 and 1999, respectively. The Company markets *Botox*® in the United States and in 69 other countries. Allergan will continue to develop, manufacture and market *Botox*® after completion of the spin-off transaction described above.

The approved indications for *Botox*® in the United States are for the treatment of blepharospasm (the uncontrollable contraction of the eyelid muscles which can force the eye closed and result in functional blindness); strabismus (misalignment of the eyes) in people 12 years of age and over; and cervical dystonia in adults (along with the associated pain). *Botox*® has been approved in Japan for the treatment of blepharospasm, strabismus, and, in 2001, for use in treating cervical dystonia. Outside of the U.S. and Japan, *Botox*® is also approved for treating hemifacial spasm, blepharospasm, pediatric cerebral palsy, hyperhidrosis (excessive sweating) and upper limb spasticity associated with debilities occurring after a stroke.

The Company is pursuing new approved indications for *Botox*®, including brow furrow, headache, back spasm and spasticity.

In October 2001, *Botox*® was granted a positive opinion by the European Commission for focal spasticity of the wrist and hand in adult post-stroke patients, an approval from Health Canada for the management of focal spasticity, including the treatment of upper limb spasticity associated with adult post-stroke patients, and was granted approval for hyperhidrosis and brow furrow in New Zealand.

Botox® Cosmetic

Botox® Cosmetic is designed to relax wrinkle-causing muscles to smooth the deep, persistent, glabellar lines between the brow that often develop during the aging process. The first North American approval for *Botox*® Cosmetic was received in Canada in April 2001, and is anticipated in the United States in the first quarter of 2002. The Canadian approval of *Botox*® Cosmetic launched the first direct-to-consumer marketing campaign aimed at building the product market. Once approved by the FDA, Allergan intends to launch its advertising campaign for *Botox*® Cosmetic in the United States in the first quarter of 2002. Aesthetic-oriented physicians will also be offered Allergan-sponsored training to further expand the base of qualified physicians using *Botox*® Cosmetic. In December 2000, the Company also submitted a variation to its *Botox*® Marketing Authorization license in France for the treatment of glabellar lines.

Optical Medical Devices

Ophthalmic Surgical Product Line

Allergan s ophthalmic surgical business develops, manufactures and markets intraocular lenses (IOLs), phacoemulsification equipment, viscoelastics, and other products related to cataract surgery. As part of the spin-off transaction described above, Allergan s ophthalmic surgical business will be part of AMO.

The largest segment of the surgical market is for the treatment of cataracts. Cataracts are a condition, usually age related, in which the natural lens of the eye becomes progressively clouded. This clouding obstructs the passage of light and can eventually lead to blindness. Most patients affected by cataracts can be surgically treated by removing the clouded lens and replacing it with an IOL. The Company currently offers a line of products used in the performance of cataract surgery, including silicone monofocal and multi-focal IOLs, an acrylic IOL and PMMA (polymethylmethacrylate) IOLs.

Sales of all models of the Company s IOLs represented approximately 10% of total Company sales in 2001 and 11% of total Company sales in each of 2000 and 1999. Foldable IOLs marketed by Allergan for small incision cataract surgery include the *Array*® multifocal silicone IOL; its line of monofocal silicone IOLs (*PhacoflexII*®*SI-30NB*®, *SI-40NB*®, and *PhacoflexII*®*SI-55NB*®); and the *Sensar*® acrylic IOL, which was introduced in Europe in 1998, was

Table of Contents

approved for marketing in the United States in February 2000 and in Japan in April 2001. *ClariFlex*®, Allergan s third-generation silicone IOL, was launched in Europe in May 2001, and in the United States in November 2001. In January 2002, *ClariFlex*® was approved in Japan. Along with foldable IOLs, the Company also markets a series of insertion systems for each of its foldable lens models, referred to as *The UnFolder*® implantation systems. The systems assist the surgeon in achieving controlled release of the IOL in incisions as small as 2.8 mm.

Phacoemulsification is a method of cataract extraction that uses ultrasound waves to break the natural lens into small fragments that can then be removed. Allergan currently markets the *Prestige*®, *AMO*®*Diplomax*® and *Sovereign*™ phacoemulsification systems. Allergan also markets *AMO*®*Vitrax*®, a viscoelastic used to maintain the anterior chamber and protect endothelial cells during cataract surgery. In 1998, the Company became a distributor of *BioLon*® viscoelastic in the United States under an agreement with Akorn, Inc. The Company has partnered with Allegiance Healthcare Corporation to provide custom surgical procedure packs to its U.S. and European customers.

Allergan competes in the refractive surgery market with the *Amadeus*™ microkeratome. Surgeons use microkeratomes in LASIK procedures to cut a flap of corneal tissue that is folded back during the laser procedure and then folded back to its original position. Allergan is the exclusive worldwide distributor of the *Amadeus*™ microkeratome and *SurePass*® microkeratome blades, which are manufactured by SIS AG, Surgical Instrument Systems in Switzerland. Allergan also has a co-marketing agreement with VISX Incorporated, which sells excimer laser systems for vision correction.

Contact Lens Care Product Line

The Company has been active in the contact lens care market since 1960. On a worldwide basis, it develops, manufactures and markets a broad range of products for use with every available type of contact lens. These products include disinfecting solutions to destroy harmful micro-organisms in and on the surface of contact lenses; daily cleaners to remove undesirable film and deposits from contact lenses; enzymatic cleaners to remove protein deposits from contact lenses; and lens rewetting drops to provide added wearing comfort. As part of the spin-off transaction described above, Allergan s contact lens care business will be part of AMO.

In the area of disinfecting products for soft contact lenses, the Company offers products that can be used in both the hydrogen peroxide and convenient chemical systems. Allergan s leading hydrogen peroxide system products are the *Oxysept 1Step*®*/UltraCare*® hydrogen peroxide neutralizer/disinfection system, with a color indicator which turns the solution pink to indicate the disinfectant tablet has dissolved. *Complete*® brand Multi-Purpose Solution is the Company s convenient, cold-chemical one-bottle disinfection system for soft contact lenses. The Company currently markets *Complete*® brand Multi-Purpose Solution worldwide, including Japan as of 1999. *Complete*® brand *ComfortPLUS*™ Multi-Purpose Solution, the Company s latest product upgrade, contains a proprietary comfort formulation for longer, more comfortable contact lens wear. In February 2001, *Complete*® brand Multi-Purpose Solution was approved in the U.S. for cleaning frequent-replacement (30 days or less) soft contact lenses without having to rub them. In February 2002, *Complete*® brand Multi-Purpose Solution was approved in the U.S. for cleaning all soft contact lenses without having to rub them.

In November 1995, the Company acquired the worldwide contact lens care business of Pilkington Barnes Hind. Included in the acquisition was the *Consept F*® Cleaning and Disinfecting System, the first approved non-heat disinfection system for soft contact lenses in Japan. This acquisition significantly increased the Company s contact lens care product business in Japan. In April 2001, Japanese regulatory authorities also approved the *Consept One Step*® contact lens care system.

The Company s contact lens care business continues to be impacted by trends in the contact lens and lens care marketplace, including technological and medical advances in surgical techniques for the correction of vision impairment and by daily disposable lenses. Cheaper cold-chemical one-bottle disinfection systems have gained popularity among soft contact lens wearers instead of peroxide-based lens care products which have historically been Allergan s strongest family of lens care products. The Company s primary strategy is to focus its sales and marketing resources on aggressive growth of *Complete*® brand Multi-Purpose Solution. Also, the growing use and acceptance of daily contact lenses, along with the other factors above, could have the effect of reducing demand for lens care products generally.

Table of Contents

Employee Relations

At December 31, 2001, the Company employed approximately 6,436 persons throughout the world, including 2,633 in the United States. None of the Company s U.S.-based employees are represented by unions. The Company considers that its relations with its employees are, in general, very good.

International Operations

Allergan s international sales have represented approximately 44.6%, 48.3% and 51.9% of total sales for the years ended December 31, 2001, 2000 and 1999, respectively. The Company s 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

Allergan maintains a global marketing team, as well as regional sales and marketing organizations. Allergan s sales efforts and promotional activities are primarily aimed at eye care professionals, as well as neurologists and dermatologists, who use, prescribe and recommend its products. In addition, Allergan advertises in professional journals and has an extensive direct mail program of descriptive product literature and scientific information to specialists in the ophthalmic, dermatological and movement disorder fields. The Company has also developed training modules and seminars to update physicians regarding evolving technology. Allergan has also utilized direct-to-consumer advertising of its contact lens care products, *Refresh*® products and *Array*® multifocal silicone IOL.

The Company s 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 neurologists, dermatologists and plastic surgeons. At December 31, 2001, the Company employed approximately 1,700 sales representatives throughout the world. The Company also utilizes distributors for its products in the smaller international markets.

Research and Development

The Company s global research and development efforts focus on eye care, skin care and neuromuscular products that are safe, effective, convenient and have an economic benefit. The Company s own research and development activities are supplemented by a commitment to identifying and obtaining new technologies through in-licensing, technological collaborations, joint ventures and acquisition efforts, including the establishment of research relationships with academic institutions and individual researchers.

At December 31, 2001, there were, in the aggregate, approximately 1,100 people involved in the Company s research and development efforts. The Company s research and development expenditures for 2001, 2000 and 1999 were $256.5 million, $195.6 million and $168.4 million, respectively, including amounts spent by the Company in conjunction with the acquisition of Allergan Specialty Therapeutics, Inc., which is described below.

Research and development efforts for the ophthalmic pharmaceuticals business focus primarily on new therapeutic products for glaucoma, inflammation, dry eye, allergy, anti-infective pharmaceuticals for eye care and back-of-the-eye disorders, including macular degeneration. Below is a summary of major research and development projects in the ophthalmic pharmaceutical segment:

In its glaucoma research, the Company is pursuing two approaches. The first is to improve upon agents for lowering IOP, and the second is to develop drugs that directly protect the optic nerve.

In the retinal disease area, Allergan is continuing programs to treat age-related macular degeneration.

Allergan continues to pursue ocular allergy, anti-inflammatory and anti-infective products.

Table of Contents

Research and development activities for the surgical business concentrate on improved cataract surgical systems, implantation instruments and methods, and new IOL materials and designs.

For the skin care business, Allergan s research and development team is working on expanded indications and formulations for tazarotene. The team is also working on an anti-acne approach based on enzyme inhibitors.

Research and development efforts for neuromuscular disorders focus on expanding the uses for *Botox*® (Botulinum Toxin Type A) to include treatment for spasticity, headache, lower back pain, brow furrow and hyperhidrosis. Allergan is also pursuing new toxin based products.

Research and development in the contact lens care business is aimed at systems that are effective and more convenient for patients to use, and thus lead to a higher rate of compliance with recommended lens care procedures. Improved compliance can enhance safety and extend the time a patient will be a contact lens wearer.

Allergan is also working to leverage its technologies in therapeutic areas outside of its current specialties, such as the use of its receptor-selective retinoid technology in therapeutic areas such as cancer, diabetes, dyslipidermia and bone disease and alpha agonists in the treatment of neuropathic pain.

In 1997, the Company formed a new subsidiary, Allergan Specialty Therapeutics, Inc. (ASTI), to conduct research and development of potential pharmaceutical products based on the Company s retinoid and neuroprotective technologies. In March 1998, the Company distributed all ASTI Class A Common Stock to the Company s stockholders, who received one share of ASTI Class A Common Stock for each 20 shares of Allergan common stock held as of the record date.

In April 2001, the Company exercised its option under the terms of ASTI s Restated Certificate of Incorporation to repurchase all of the outstanding shares of ASTI Class A Common Stock at a price of $21.70 per share, for an aggregate purchase price of $71.0 million. Please refer to ASTI s Restated Certificate of Incorporation (which has been filed previously with the U.S. Securities and Exchange Commission) and to ASTI s Annual Report on Form 10-K for the year ended December 31, 2000, for more information on Allergan s repurchase option. During the second quarter of 2001, Allergan incurred a $40 million one-time charge related to in-process research and development and capitalized the value of core technology on its balance sheet. In addition, Allergan s consolidated financial statements for fiscal year 2001 include the assets, liabilities and results of operations of ASTI from the date of purchase.

Allergan established a plan to fully fund most of the former ASTI technology programs (which technologies are more fully described in ASTI s Form 10-K for the year ended December 31, 2000). The continuing programs are being funded either through the use of partnering arrangements, third party research and development organizations, or directly by Allergan.

The Company has also entered into a series of agreements to further its research and development efforts:

In January 2002, the Company entered into an exclusive License Agreement with EntreMed, Inc. for the use of up to two non-peptide angiostatic compounds in the treatment and prevention of diseases and conditions of the eye, such as macular degeneration, by local delivery of an inhibitor of angiogenesis, which includes *Panzem*™, described below.

In January 2002, the Company announced an an agreement with Ophtec BV and Ophtec USA, Inc., a Netherlands-based medical device manufacturer, under which the Company will seek to introduce a new IOL based on lens technology developed by Ophtec, once regulatory approval is received. In connection with the spin-off transaction described above, this agreement will be assigned by the Company to AMO. AMO will market this new brand of IOL exclusively in the U.S., Canada, Mexico and Japan. In the European region and the rest of the world, Ophtec will continue to distribute its product and AMO will market and sell its own brand.

In May 2001, Allergan and Oculex Pharmaceuticals, Inc. entered into a license and research collaboration agreement to discover, develop and commercialize compounds for ophthalmic use, based upon Oculex s proprietary biodegradable and reservoir drug delivery technologies. In January 2002, the Company and

Table of Contents

Oculex entered into an agreement for the development and manufacture of a new drug product that contains *Panzem*™, a compound licensed to Allergan by EntreMed, Inc., for the treatment of age-related macular degeneration.

In April 2001, the Company entered into agreements with Bardeen Sciences Company, LLC (BSC) pursuant to which the Company transferred to BSC a portfolio of compounds and projects, agreed to perform research and development on the portfolio in exchange for a fee from BSC, acquired certain commercialization rights to the portfolio, and acquired an option to acquire, under certain circumstances, all of the outstanding equity of BSC. See Note 6, Bardeen Sciences Company, LLC, in the Notes to Consolidated Financial Statements.

In December 2000, Allergan obtained a license from Photochemical Co., Ltd., of Japan to develop and commercialize ATX-S10, an early stage compound used for photodynamic therapy to treat age-related macular degeneration, the leading cause of blindness in people over the age of 50.

In December 2000, the Company and Aurora Biosciences Corporation announced a collaboration to develop functional cell-based assays for several key G protein-coupled receptor targets, and to screen those targets to identify lead drug candidates.

The continuing introduction of new products supplied by the Company s research and development efforts and in-licensing opportunities is critical to the success of the Company. There are intrinsic uncertainties associated with the research and development efforts and the regulatory process. There is no assurance that any of the research projects or pending drug marketing approval applications will result in new products that the Company can commercialize. Delays or failures in one or more significant research projects and pending drug marketing approval applications could have a material adverse impact on the future operations of the Company.

Competition

Allergan faces strong competition in all of its markets worldwide. Numerous companies are engaged in the development, manufacture and marketing of health care products competitive with those manufactured by Allergan. Major eye care competitors include Alcon Laboratories, Inc., Bausch & Lomb, Chiron Vision and Storz Ophthalmics, Novartis Ophthalmics, Merck & Co., Inc. and Pharmacia Ophthalmics. These competitors have equivalent or, in most cases, greater resources than Allergan. The Company s skin care business competes against a number of companies, including among others Dermik, a division of Aventis, Galderma, a joint venture between Nestlé and L Oreal, Bristol-Myers Squibb, Schering-Plough Corporation, Johnson & Johnson and Hoffman-La Roche Inc., which all have greater resources than Allergan. In the market for neurotoxins, the Company has two competitors: Beaufour Ipsen, which sells in Europe, Latin America, Asia and New Zealand, and Elan Corporation, PLC, which sells in the United States and Europe. In marketing its 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, the Company competes primarily on the basis of product technology, value-added services and price. The Company believes that it competes favorably in its product markets.

Government Regulation

Drugs, biologics and medical devices, including IOLs and contact lens care products, are subject to regulation by the FDA, state agencies and, in varying degrees, by foreign health agencies. Government regulation of most of the Company s products generally requires extensive testing of new products and filing applications for approval by the FDA prior to sale in the United States and by foreign health agencies prior to sale as well. The FDA and foreign health agencies review these applications and determine whether the product is safe and effective. The process of developing data to support a premarket application and governmental review is costly and takes many years to complete.

In general, manufacturers of drugs, medical devices and biologicals are operating in a rigorous regulatory environment. 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 U.S., which are faced with significant pressure to lower health care costs.

Table of Contents

Internationally, the regulation of drugs and medical devices is also complex. In Europe, the Company s products are subject to extensive regulatory requirements. As in the U.S., 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 of adverse events to the competent authorities. The European Union (EU) 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 mutual recognition and centralized procedure are expected later this year. 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 U.S., reimbursement pricing is typically regulated by government agencies.

The EU regulatory regime for medical devices became mandatory in June 1998. It requires that medical devices may only be placed on the market if they do not compromise safety and health when properly installed, maintained and used in accordance with their intended purpose. National laws conforming to this EU legislation regulate the Company s IOLs and contact lens care products under the medical devices regulatory system rather than the more extensive system for medicinal products under which they were formerly regulated. The EU medical device laws require manufacturers to declare that their products conform to the essential regulatory requirements after which the products may be placed on the market bearing CE marking. The manufacturers quality systems for products in all but the lowest risk classification are also subject to certification and audit by an independent notified body.

In Japan, where the Company currently sells surgical products, consumer eye care products and *Botox*®, the regulatory process is equally complex. Premarketing approval and clinical studies are required, as is governmental pricing approval for medical devices and pharmaceuticals. The regulatory regime for pharmaceuticals in Japan has historically been so lengthy and costly that it has been cost prohibitive for Allergan, primarily because Japan required the repetition of all relevant clinical studies in Japan. In the future, the process in Japan may become more financially attractive as Japan is in the process of implementing changes to comply with the International Conference on Harmonization, an agreement among Japan, the U.S. and the EU 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 period of transition are not certain and in this period registration of pharmaceutical products will remain unpredictable; however, the opportunity to realize value in Japan from Allergan s newly developed products in Japan may increase as the environment in Japan moves closer to that of the EU and U.S.

In the U.S., a significant percentage of the patients who receive the Company s IOLs are covered by the federal Medicare program. When a cataract extraction with IOL implantation is performed in an ambulatory surgery center (ASC), Medicare provides the ASC with a fixed facility fee which includes a recommended $150 allowance to cover the cost of the IOL. The reimbursement rate for *Array*® multifocal IOLs implanted in ASCs until May 2005 is $200 after HCFA awarded new technology IOL status to the *Array*® multifocal IOL in 2000. When the procedure is performed in a hospital outpatient department, the hospital s reimbursement is determined using a complex formula that blends the hospital s costs with the $150 allowance paid to ASCs for IOLs that are not new technology IOLs. For the *Array*® multifocal IOL, Medicare reimburses the hospital based on the actual acquisition cost of the IOL by the hospital.

Proposals to amend Medicare coverage to include pharmaceuticals are currently in debate in the U.S. Such coverage could impose price controls on the Company s products. If implemented, price controls could materially and adversely affect the Company s revenues and financial condition.

The Company cannot predict the likelihood or pace of any significant regulatory or legislative action in these areas, nor can it 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. The Company also cannot predict with precision what effect such governmental measures would have if they were ultimately enacted into law. However, in general, the Company believes that such legislative activity will likely continue, and the adoption of such measures can be expected to have some impact on the Company s business.

Table of Contents

Patents, Trademarks and Licenses

Allergan owns, or is licensed under, numerous patents relating to its products, product uses and manufacturing processes. It has numerous patents issued in the United States and corresponding foreign patents issued in many of the major countries in which it does business. Allergan believes that its patents and licenses are important to its business, but that with the exception of those relating to *Alphagan*® and *Lumigan*®, no one patent or license is currently of material importance in relation to its overall sales. Allergan markets its products under various trademarks and considers these trademarks to be valuable because of their contribution to the market identification of the various products. See Item 3, Legal Proceedings, on page 13.

Environmental Matters

The Company is subject to federal, state, local and foreign environmental laws and regulations. The Company believes that its operations comply in all material respects with applicable environmental laws and regulations in each country where the Company has a business presence. Although Allergan continues to make capital expenditures for environmental protection, it does not anticipate any significant expenditures in order to comply with such laws and regulations which would have a material impact on the Company s capital expenditures, earnings or competitive position. The Company is 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 impact on the Company s financial position. There can be no assurance, however, that environmental problems relating to properties owned or operated by the Company will not develop in the future, and the Company cannot predict whether any such problems, if they were to develop, could require significant expenditures on the part of the Company. In addition, the Company is unable to predict what legislation or regulations may be adopted or enacted in the future with respect to environmental protection and waste disposal.

Certain Factors and Trends Affecting Allergan and Its Businesses

Certain statements made by the Company in this report and in other reports and statements released by the Company constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, such as comments which express the Company s opinions about trends and factors which may impact future operating results. Disclosures that use words such as the Company believes, anticipates, expects and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from expectations. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in context with the various disclosures made by the Company about its businesses including, without limitation, the factors discussed below.

The pharmaceutical industry and other health care-related industries continue to experience consolidation, resulting in larger, more diversified companies with greater resources than the Company. Among other things, these larger companies can spread their research and development costs over much broader revenue bases than Allergan and can influence customer and distributor buying decisions.

Until December 2000, the Company was the only manufacturer of an FDA-approved neurotoxin. Another company has now received FDA approval of a neurotoxin. The Company s sales of *Botox*® could be materially and negatively impacted by this competition or competition from other companies that might obtain approval to market a neurotoxin.

The manufacturing process to create bulk toxin raw material necessary to produce *Botox*® is technically complicated. Any failure of the Company to maintain an adequate supply of bulk toxin and finished product could result in an interruption in the supply of *Botox*® and a resulting decrease in sales of the product.

The Company s contact lens care business continues to be impacted by trends in the contact lens and lens care marketplace, including technological and medical advances in surgical techniques for the correction of vision impairment. Cheaper cold-chemical one-bottle disinfection systems continue to

Table of Contents

gain popularity among soft contact lens wearers instead of peroxide-based lens care products which historically have been Allergan s strongest family of lens care products. The Company s primary strategy is to focus its sales and marketing resources on aggressive growth of *Complete*® brand Multi-Purpose Solution. The growing use and acceptance of daily contact lenses and laser-correction procedures, along with the other factors above, could have the effect of reducing demand for lens care products generally. While the Company believes it has established appropriate marketing and sales plans to mitigate the impact of these trends upon its contact lens care business, no assurance can be given in this regard.

The Company has in the past been, and continues to be, subject to product liability claims. In addition, the Company has in the past and may in the future recall or issue field corrections related to its products due to manufacturing deficiencies, labeling errors or other safety or regulatory reasons. There can be no assurance that the Company will not experience material losses due to product liability claims or product recalls or corrections.

Sales of the Company s surgical and pharmaceutical products have been and are expected to continue to be impacted by continuing pricing pressures resulting from various government initiatives as well as from the purchasing and operational decisions made by managed care organizations.

A continuing political issue of debate in the United States is the propriety of expanding Medicare coverage to include pharmaceutical products. Furthermore, individual states have become increasingly aggressive in passing legislation and regulations designed to force pharmaceutical makers to discount their products in such states. If these measures become law, and if these measures impose price controls on the Company s products or otherwise drive down the Company s pharmaceutical prices, the Company s revenues and financial condition are likely to be materially and adversely affected.

The Company collects and pays a substantial portion of its sales and expenditures in currencies other than the U.S. dollar. Therefore, fluctuations in foreign currency exchange rates affect the Company s operating results. The Company can provide no assurance that future exchange rate movements will not have a material adverse effect on the Company s sales, gross profit or operating expenses.

The Company s business is also subject to other risks generally associated with doing business abroad, such as political unrest and changing economic conditions with countries where the Company s products are sold or manufactured. Management cannot provide assurances that it can successfully manage these risks or avoid their effects.

Patent protection is generally important in the pharmaceutical industry. Therefore, Allergan s future financial success may depend in part on obtaining patent protection for technologies incorporated into products. No assurance can be given that patents will be issued covering any products, or that any existing patents or patents issued in the future 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 there can be no assurance that any such patents will not be successfully challenged in the future. If the Company is unsuccessful in obtaining or preserving patent protection, or if any products rely on unpatented proprietary technology, there can be no assurance that others will not commercialize products substantially identical to such products. Furthermore, although Allergan has a corporate policy not to infringe the valid and enforceable patents of others, Allergan cannot provide assurances that its products will not infringe patents held by third parties. In such event, licenses from such third parties may not be available or may not be available on commercially attractive terms. Please see Item 3 on page 13 for information on current patent litigation.

The Company sells its pharmaceutical products primarily through wholesalers. Wholesaler purchases may exceed customer demand, resulting in reduced wholesaler purchases in later quarters. The Company can give no assurances that wholesaler purchases will not decline as a result of this potential excess buying.

Table of Contents

Future performance of the Company will be affected by the introduction of new products such as *Lumigan*® and *Alphagan*® P, as well as FDA approval of new indications for current products such as *Botox*®. The Company has allocated significant resources to the development and introduction of new products and indications. The successful development, regulatory approval and market acceptance of the products and indications cannot be assured.

The Company anticipates that the separation of the Company s pharmaceutical and optical medical device businesses into two independent companies through a spin-off distribution of the Company s ophthalmic surgical and contact lens care businesses will occur at mid-year 2002. The Company cannot assure the success of the spin-off transaction, its costs or the effects it will have on the Company, its businesses, properties, employees and operations.

There are intrinsic uncertainties associated with research and development efforts and the regulatory process, both of which are discussed in greater details in the Research and Development and the Government Regulation sections of this report on Form 10-K, which are incorporated herein by reference.

Item 2. Properties

Allergan s operations are conducted in owned and leased facilities located throughout the world. The Company believes its present facilities are adequate for its current needs. Its headquarters and primary administrative and research facilities are located in Irvine, California. The Company has three additional facilities in California, two for raw material support (one leased and one owned) and one leased administrative facility. The Company owns one facility in Texas for manufacturing and warehousing, and the Company leases one facility in Puerto Rico for manufacturing and warehousing.

Outside of the United States and Puerto Rico, the Company owns and operates three manufacturing and warehousing facilities located in Brazil, Ireland and China. Other material facilities include one owned facility for administration and warehousing in Argentina; leased warehouse facilities in Mexico and Japan; leased administrative facilities in Australia, Brazil, Canada, France, Germany, Hong Kong, Ireland, Italy, Japan, Spain and the United Kingdom; and one leased facility in Japan used for administration and research and development.

Item 3. Legal Proceedings

The Company is involved in various lawsuits and claims arising in the normal course of business.

On March 1, 2001, after concluding that Pharmacia Corporation planned to file a patent infringement lawsuit against the Company regarding the glaucoma drug *Lumigan*®, the Company filed a declaratory relief lawsuit against Pharmacia (and related entities) in the United States District Court for the District of Delaware. In the lawsuit, the Company asked the court to issue a ruling that *Lumigan*® does not infringe certain patents owned or controlled by Pharmacia and also that such patents are not valid. On March 21, 2001, Pharmacia filed an answer to the complaint, denying Allergan s allegations. Pharmacia and Columbia University also filed a counterclaim against Allergan, alleging that Allergan infringes the same two patents that Allergan identified in its complaint. On April 10, 2001, Allergan filed its answer to the counterclaim of Pharmacia and Columbia, as well as a counterclaim in reply against Columbia. Trial is currently scheduled to begin on October 21, 2002. See Certain Factors and Trends Affecting Allergan and its Businesses for further information about the risks and uncertainties associated with patents.

On December 20, 2001, a class action lawsuit entitled Citizens for Consumer Justice, etc. v. Abbott Laboratories, Inc., Allergan, Inc., etc. was filed in United States District Court in Massachusetts. The lawsuit contends that 29 pharmaceutical companies, including Allergan, violated the Sherman Antitrust Act, as well as the Racketeering Influenced and Corrupt Organization Act (RICO), by manipulating the average wholesale price of pharmaceuticals, selling drugs to health care providers at a price substantially less than the price health care providers charged Medicare beneficiaries and encouraging health care providers to claim Medicare reimbursement for free samples.

Table of Contents

On June 6, 2001, after receiving paragraph 4 invalidity and noninfringement Hatch-Waxman Act certifications from Apotex indicating that Apotex Corp. had filed an Abbreviated New Drug Application (ANDA) for a generic form of *Acular*®, Allergan, along with Syntex, the holder of the patent, filed a patent infringement lawsuit against Apotex, Inc., Apotex Corp. and Novex Pharma in the Northern District of California. In addition, Allergan has filed a lawsuit in Canada against Apotex similarly relating to a generic version of *Acular*® in Canada. In the complaint, Allergan and Syntex asked the Court to find that the *Acular*® patent at issue is valid and infringed by the drug product sought to be approved in the Apotex ANDA.

On or about January 8, 2002, after receiving paragraph 4 invalidity and noninfringement Hatch-Waxman Act certifications from Bausch & Lomb and Alcon Laboratories indicating that both had filed ANDAs for a generic form of *Alphagan*®, Allergan filed a patent infringement lawsuit against Bausch & Lomb and Alcon Laboratories in the Central District of California. In the complaint, Allergan 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 Bausch & Lomb and Alcon ANDAs.

Although the ultimate outcome of any pending litigation or claims cannot be ascertained at this time, Allergan currently believes that the liability, if any, resulting from the aggregate amount of uninsured damages for outstanding lawsuits, investigations and asserted claims will not have a material adverse effect on its consolidated financial position and results of operation. However, in view of the unpredictable nature of such matters, no assurances can be given in this regard.

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

The Company 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.

Item I-A. Executive Officers of Allergan, Inc.

The executive officers of the Company and their ages as of March 1, 2002 are as follows:

David E.I. Pyott	48	Chairman of the Board, President and Chief Executive Officer
F. Michael Ball	46	Corporate Vice President and President, North America Region and Global Eye Rx Business
Eric K. Brandt	39	Corporate Vice President and Chief Financial Officer (Principal Financial Officer)
David A. Fellows	45	Corporate Vice President and President, Europe, Africa, Asia Pacific Region
James M. Hindman, CPA	41	Senior Vice President and Controller (Principal Accounting Officer)
Douglas S. Ingram, Esq.	39	Corporate Vice President, General Counsel and Secretary
Lester J. Kaplan, Ph.D.	51	Corporate Vice President and President, Research and Development and Global *BOTOX*®
George M. Lasezkay, Pharm.D., J.D.	50	Corporate Vice President, Corporate Development
Nelson R. A. Marques	50	Corporate Vice President and President, Latin America Region

Table of Contents

James V. Mazzo 44 Corporate Vice President
and President, Surgical and CLCP
Businesses Jacqueline Schiavo 53 Corporate
Vice President,
Worldwide Operations

Officers are appointed by and hold office at the pleasure of the Board of Directors.

Mr. Pyott was appointed Chairman of the Board in April 2001, and has been the Company s President and Chief Executive Officer since January 1998. Previously, he was head of the Nutrition Division and a member of the executive committee of Novartis AG from 1995 until December 1997. From 1992 to 1995 Mr. Pyott was President and Chief Executive Officer of Sandoz Nutrition Corp., Minneapolis, Minnesota and General Manager of Sandoz Nutrition, Barcelona, Spain from 1990 to 1992. Prior to that Mr. Pyott held various positions within Sandoz Nutrition group from 1980.

Mr. Ball has been Corporate Vice President and President, North America Region and Global Eye Rx Business since May 1998 and prior to that was Corporate Vice President and President, North America Region since April 1996. He joined the Company in 1995 as Senior Vice President, U.S. Eye Care after 12 years with Syntex Corporation, where he held a variety of positions including President, Syntex Inc. Canada and Senior Vice President, Syntex Laboratories.

Mr. Brandt has been Corporate Vice President and Chief Financial Officer since May 1999 and from January 2001 to January 2002 he also assumed the duties of President, Global Consumer Eye Care Business. Prior to joining the Company, Mr. Brandt held various positions with the Boston Consulting Group (BCG) from 1989, culminating in Vice President and Partner, and a senior member of the BCG Health Care practice. While at BCG, Mr. Brandt was involved in high level consulting engagements with top global pharmaceutical, managed care and medical device companies, focusing on corporate finance, shareholder value and post-merger integration. Mr. Brandt joined the Company in 1999.

Mr. Fellows has been Corporate Vice President and President of the Asia Pacific Region since June 1997 and in January 2002 he assumed the new title of President, Europe, Africa, Asia Pacific Region. Previously he was Senior Vice President, U.S. Eye Care Marketing since June 1996. From 1993 to 1996, he was Senior Vice President, Therapeutics Strategic Marketing, and from 1991 until 1993, he was Vice President, Pharmaceuticals Strategic Marketing. Mr. Fellows joined the Company in 1980.

Mr. Hindman has been Senior Vice President and Controller since January 2000 and prior thereto was Vice President, Financial Planning & Analysis since February 1997. Prior to that he served 12 years in a variety of positions at the Company, including Plant Controller, Director of Manufacturing Planning and Reporting, Director of Finance (Northwest Europe), and Assistant Corporate Controller. Mr. Hindman first joined the Company in 1984.

Mr. Ingram has been Corporate Vice President, General Counsel and Secretary, as well as the Company s Chief Ethics Officer, since July 2001. Prior thereto he was Senior Vice President and General Counsel of the Company since January 2001, and its Assistant Secretary since November 1998. Prior to that, Mr. Ingram was the Company s Associate General Counsel from August 1998, its Assistant General Counsel from January 1998 and Senior Attorney and Chief Litigation Counsel from March 1996, when he first joined the Company. Prior to joining the Company, Mr. Ingram was, from August 1988 to March 1996, an attorney with the law firm of Gibson, Dunn & Crutcher.

Dr. Kaplan has been Corporate Vice President and President, Research and Development and Global BOTOX® since May 1998 and had been Corporate Vice President, Science and Technology since July 1996. From 1992 until 1996, he was Corporate Vice President, Research and Development. He had been Senior Vice President, Pharmaceutical Research and Development since 1991 and Senior Vice President, Research and Development since 1989. Dr. Kaplan first joined the Company in 1983.

Table of Contents

Dr. Lasezkay has been Corporate Vice President, Corporate Development since October 1998 and had been Vice President, Corporate Development since July 1996. He had been Assistant General Counsel of the Company since 1995 and Senior Counsel to the Company since 1989 when he first joined the Company.

Mr. Marques has been Corporate Vice President and President, Latin America Region since October 1998. Prior to that he served 18 years with Alcon, where he held a variety of positions, including President, Alcon Laboratories do Brasil Ltda. from 1994 until 1998. Mr. Marques joined the Company in 1998.

Mr. Mazzo has been Corporate Vice President and President, Surgical and CLCP Businesses since January 2002. Prior to that he had been Corporate Vice President and President, Europe/Africa/Middle East Region since April 1998, and since January 2001 had served as President, Global Surgical Business. From May 1998 to January 2001 Mr. Mazzo was also the President of Global Lens Care Products. He had been Senior Vice President Eyecare/Rx Sales and Marketing, U.S. since June 1997 during which time he served as acting President Europe/Africa/Middle East Region from October December 1997. Prior to that, he served 11 years in a variety of positions at the Company, including Director, Marketing (Canada), Vice President and Managing Director (Italy) and Senior Vice President Northern Europe. Mr. Mazzo first joined the Company in 1980. Mr. Mazzo has been appointed by the Advanced Medical Optics, Inc. Board of Directors to serve as the President and Chief Executive Officer of Advanced Medical Optics, Inc.

Ms. Schiavo has been Corporate Vice President, Worldwide Operations since 1992. She was Senior Vice President, Operations from 1991 and Vice President, Operations from 1989. Ms. Schiavo first joined the Company in 1980.

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

The following table shows the quarterly price range of the Common Stock and the cash dividends declared per share during the periods listed.

	2001			*2000*		
Calendar Quarter	*Low*	*High*	*Div.*	*Low*	*High*	*Div.*
First	$59.00	$99.38	$0.09	$44.50	$63.94	$.08
Second	71.13	93.30	0.09	49.88	78.75	.08
Third	60.00	86.25	0.09	64.75	90.31	.08
Fourth	64.26	78.10	0.09	67.13	101.13	.08

Allergan 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 7,500 as of January 31, 2002.

On January 18, 2002, the Board declared a cash dividend of $0.09 per share, payable March 14, 2002 to stockholders of record on February 15, 2002. See Note 9 of Notes to Consolidated Financial Statements relative to restrictions on dividend payments.

Table of Contents

Item 6. Selected Financial Data

(in millions, except per share data)	Year Ended December 31, 2001	2000	1999	1998	1997
Summary of Operations					
Product net sales	$1,685.2	$1,562.6	$1,406.2	$1,261.7	$1,138.0
Research service revenues, primarily from a related party (through April 16, 2001)	60.3	62.9	46.2	34.4	11.0
Operating costs and expenses:					
Cost of product sales	410.2	429.1	406.4	407.0	399.3
Cost of research services	56.1	59.4	43.3	32.1	10.4
Selling, general and administrative	704.0	650.1	587.9	525.2	459.1
Technology fees from related party	(0.7)	(3.1)	(6.1)	(11.2)	
Research and development	256.5	195.6	168.4	125.4	131.2
Restructuring charge (reversal)	(1.7)	(2.0)	(9.6)	74.8	
Asset write-offs (reversal)		(1.4)		58.5	
Contribution to Allergan Specialty Therapeutics, Inc.					171.4
Operating income (loss)	321.1	296.4	263.5	(87.1)	149.0
Non-operating income	15.3	7.4	5.5	29.4	8.1
Earnings (loss) before income taxes and minority interest	336.4	303.8	269.0	(57.7)	157.1
Net earnings (loss)	224.9	215.1	188.2	(90.2)	128.3
Basic earnings (loss) per common share	1.71	1.65	1.42	(0.69)	0.98
Diluted earnings (loss) per common share	1.68	1.61	1.39	(0.69)	0.97
Cash dividends per share	0.36	0.32	0.28	0.26	0.26
Financial Position					

Current assets				
$1,325.3	$1,326.3	$697.5	$661.2	$636.4
Working capital				
835.3	893.8	277.6	292.7	273.1
Total assets				
2,046.2	1,971.0	1,339.1	1,334.4	1,398.9
Long-term debt				
520.6	584.7	208.8	201.1	142.5
Total stockholders equity				
977.4	873.8	634.5	696.0	841.4

The earnings per share data in years prior to 1999 has been restated to reflect the two for one stock split in December 1999 (see Note 3 of Notes to Consolidated Financial Statements).

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

Management s Discussion and Analysis of Financial Condition and Results of Operations for the Three-Year Period Ended December 31, 2001

This financial review presents the operating results for Allergan, Inc. for each of the three years in the period ended December 31, 2001, and its financial condition at December 31, 2001. This review should be read in connection with the information presented in the Consolidated Financial Statements and the related Notes to the Consolidated Financial Statements.

Allergan, Inc. (the Company), headquartered in Irvine, California, is a technology-driven, global health care company that develops and commercializes specialty pharmaceutical products for the ophthalmic, neurological, dermatological and other specialty markets as well as ophthalmic surgical devices and contact lens care solutions.

Table of Contents

Incorporated in 1948, the Company employs approximately 6,400 professionals around the world. The Company is a pioneer in specialty pharmaceutical research, targeting products and technologies related to specific disease areas such as glaucoma, retinal disease, cataracts, dry eye, psoriasis, acne, photodamage, movement disorders, metabolic disease, and various types of cancer. With 2001 sales in excess of $1.6 billion, the Company is an innovative leader in therapeutic and over-the-counter products that are sold in more than 100 countries around the world.

The Company operates in four regions: North America, Latin America, Europe and Asia Pacific. Operations for the Europe Region also include sales to customers in Africa and the Middle East, and operations in the Asia Pacific Region include sales to customers in Australia and New Zealand.

In each region, the Company markets products in two product lines: Specialty Pharmaceuticals and Optical Medical Devices. The Specialty Pharmaceutical line produces 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*® (Botulinum toxin type A) for therapeutic neuromuscular disorders and related pain as well as cosmetic facial aesthetics. The Optical Medical Devices product line consists of the Ophthalmic Surgical and Contact Lens Care businesses. The Ophthalmic Surgical line produces intraocular lenses, phacoemulsification equipment, viscoelastics, and other products related to cataract surgery. The Contact Lens Care line produces cleaning, storage and disinfection products for the consumer contact lens market. The Company provides global marketing strategy teams to ensure development and execution of a consistent marketing strategy for products in all geographic operating segments.

In 2001, 2000 and 1999, the Company has participated in the following research and development and marketing collaboration activities:

In December 2001, the Company entered into a global licensing agreement with Laboratoires Thea S.A. for the use of the ABAK™ device, a multi-dose system for the delivery of preservative-free eye drops.

In July 2001, the Company entered into an agreement with Procter and Gamble Pharmaceuticals, Inc., for the co-promotion of *Tazorac*® (tazarotene cream and gel 0.05% and 0.1%) to the general practitioner market in the United States.

In June 2001, the Company entered into a collaboration agreement with Inspire Pharmaceuticals, Inc. for the right to develop and commercialize INS365 Ophthalmic, a compound for the treatment of dry eye.

In May 2001, the Company entered into a license and collaboration agreement with Oculex Pharmaceuticals, Inc. for the right to develop and commercialize various compounds for the treatment of serious conditions affecting the retina and back of eye based on Oculex s proprietary biodegradable and reservoir drug delivery technologies.

In April 2001, the Company entered into agreements with Bardeen Sciences Company, LLC (BSC) pursuant to which the Company transferred to BSC a portfolio of compounds and projects, agreed to perform research and development on the portfolio in exchange for a fee from BSC, acquired certain commercialization rights to the portfolio, and acquired an option to acquire, under certain circumstances, all of the outstanding equity of BSC. The agreements are described more fully in Note 6 to the Consolidated Financial Statements.

In February 2001, the Company expanded to include global rights, its multi-year distribution agreement with Surgical Instrument Systems AG (SIS), to commercialize the *Amadeus*™ microkeratome.

In December 2000, the Company entered into a license agreement with Photochemical Co., Ltd., for the right to develop and commercialize ATX-S10, a compound used for photodynamic therapy of age-related macular degeneration.

In December 2000, the Company entered into a collaboration agreement with Aurora Biosciences Corporation, focused on ion channel drug discovery for ophthalmic indications.

Table of Contents

In August 2000, the Company entered into a license agreement with Kyorin Pharmaceuticals for the development and commercialization of gatifloxacin for the treatment of ocular infections in all territories except Japan, Korea, China, and Taiwan.

In August 2000, the Company entered into a Strategic Partnership Agreement with Allegiance, a subsidiary of Cardinal Health, to co-market Custom Surgical Procedure Packs in Europe, Africa, and the Middle East ophthalmic surgery markets.

In July 2000, the Company entered into a strategic global alliance with Vistakon, a division of Johnson & Johnson, that includes research, educational, marketing, and co-detailing initiatives worldwide. The Company gave a six-month notice of termination in January 2002; however many local agreements will continue.

In May 2000, the Company entered into an exclusive, multi-year distribution agreement with Surgical Instrument Systems AG (SIS), to commercialize the *Amadeus*™ microkeratome in both North America and Latin America.

In May 2000, the Company entered into a marketing alliance with VISX Incorporated to co-market Allergan Surgical products and VISX diagnostic and treatment equipment in the U.S.

In May 2000, the Company entered into a license and multi-year research collaboration agreement with the Center for Applied Microbiology and Research (CAMR) to accelerate the commercial availability of CAMR s novel neurotoxin-based technology that targets the treatment of acute and chronic pain conditions.

In March 2000, the Company entered into a collaboration agreement with ISTA Pharmaceuticals, in which it will commercialize Vitrase, a drug used for the treatment of severe vitreous hemorrhage, in all markets except Mexico and Japan.

In February 2000, the Company entered into a multi-year, multi-product segment alliance agreement with Dura Pharmaceuticals to commercialize selected Allergan products in the U.S. primary care and respiratory segments. This alliance agreement terminated in August 2001.

In December 1999, the Company acquired an exclusive license to a patented use of neurotoxins like *Botox*® in specific medical applications.

In December 1999, the Company entered into a license agreement with Boehringer Ingelheim granting the Company the right to develop and commercialize epinastine for the treatment of ocular allergies.

In November 1999, the Company entered into an agreement with 3M Pharmaceuticals, a division of Minnesota Mining and Manufacturing Company, to co-promote Allergan s proprietary acne product, *Tazorac*®, in the U.S. dermatology market. This agreement terminated in June 2001.

In October 1999, the Company entered into a three-year agreement with ChemRx Advanced Technologies, Inc. to provide the Company with a diverse compound screening library.

In September 1999, the Company entered into a multi-year agreement with McNeil Consumer Healthcare, a subsidiary of Johnson & Johnson, to commercialize Allergan s proprietary anti-infective, *Ocuflox*® (ofloxacin ophthalmic solution) 0.3%, in the U.S. pediatric and selected general practitioner markets. This agreement terminated in December 2001.

In July 1999, the Company entered into a license and research collaboration agreement with ACADIA Pharmaceuticals to discover, develop and commercialize compounds for glaucoma, based on ACADIA s proprietary receptor-selective muscarinic lead compounds.

Table of Contents

In June 1999, the Company obtained an exclusive license from XOMA Ltd. to use recombinant BPI in combination with other anti-infectives to treat ophthalmic infections. This license agreement terminated in February 2001.

In April 1999, the Company entered into a long-term marketing, sales and development partnership with Bioglan Pharma Plc to commercialize *Zorac*® (tazarotene gel 0.05% and 0.1%) in the United Kingdom, Ireland, Denmark, Sweden, Finland, and other international markets, including certain countries in the Middle East and Africa.

In February 1999, the Company entered into a long-term marketing, sales and development partnership with Pierre Fabre Dermatologie to commercialize *Zorac*® in continental Europe and nearby territories.

Subsequent Event Discontinued Operations

On January 22, 2002, the Company announced its intention to separate the Specialty Pharmaceutical and the Ophthalmic Surgical and Contact Lens Care product lines into two separate companies. The Company, subject to certain conditions, intends to launch a new company (which has been named Advanced Medical Optics, Inc.) by spinning off the Ophthalmic Surgical and Contact Lens Care businesses to its stockholders by means of a tax-free dividend. The Ophthalmic Surgical business includes intraocular lenses, phacoemulsification equipment, viscoelastics, and other refractive surgical products. The Contact Lens Care product line consists of disinfecting solutions, daily cleaners, enzymatic cleaners and lens rewetting drops. The spin-off is expected to be completed by July 1, 2002 and Advanced Medical Optics, Inc. (AMO) is expected to raise $275 million in debt financing at or before the time of the spin-off, the net proceeds of which will be used to pay-off certain existing debt with any remaining balance remitted to the Company in connection with the distribution. The Company and AMO expect to incur estimated expenses of $150 million to $200 million in connection with costs associated with the spin-off. Additionally, management has estimated that approximately $50 million to $60 million of additional annual costs will be incurred by AMO and approximately $15 million to $20 million of additional net costs will be incurred by the Company associated with dissynergies, contract manufacturing arrangements and changes in cost and debt capital structure as a result of the separation of the companies. See Note 2 to the Consolidated Financial Statements for certain AMO financial information as of December 31, 2001 and 2000 and for each of the years in the three year period ended December 31, 2001.

Results Of Operations

Net Sales

The following table sets forth, for the periods indicated, net sales by major product line.

(in millions)	Year Ended December 31, 2001	2000	1999
Specialty Pharmaceuticals:			
Eye Care Pharmaceuticals	$745.8	$675.3	$571.2
Skin Care	78.9	68.7	76.6
Botox®	309.5	239.5	175.8
Total	1,134.2	983.5	823.6

Optical Medical Devices:			
Ophthalmic Surgical	253.9	250.4	222.9
Contact Lens Care	297.1	328.7	359.7
Total	551.0	579.1	582.6
Total Product Net Sales	$1,685.2	$1,562.6	$1,406.2
Domestic	55.4%	51.7%	48.1%
International	44.6%	48.3%	51.9%

Net sales for 2001 were $1.685 billion, which was an increase of $122.6 million or 8% over 2000. Foreign currency fluctuations in 2001 decreased sales by $57.2 million or 4% as compared to average rates in effect in 2000. At constant currency rates, sales increased by $179.8 million or 12% over 2000.

Net sales increased in 2001 compared to 2000 primarily as a result of increases in sales in three product lines, partially offset by a decrease in sales of Contact Lens Care products. Eye Care Pharmaceutical sales increased by $70.5 million, or 10%; sales of *Botox*® Purified Neurotoxin Complex increased by $70.0 million, or

Table of Contents

29%; and Skin Care sales increased by $10.2 million, or 15% in 2001. Eye Care Pharmaceutical sales increased primarily as a result of the launch of the Company s new glaucoma drug, *Lumigan*® (bimatoprost ophthalmic solution 0.03%) in the first quarter, the launch of *Alphagan*® *P* (brimonidine tartrate ophthalmic solution 0.15%) ophthalmic solution for glaucoma in the third quarter, and the growth in sales of the anti-infective *Ocuflox*®. Eye Care Pharmaceutical sales increased by 20% in the United States and 4% at constant currency rates in international markets in 2001 compared to 2000. Eye Care Pharmaceutical sales in international markets decreased due to adverse currency fluctuations by $20.3 million, or 7%, primarily as a result of the decline in the value of the euro and the Brazilian real compared to the dollar. *Botox*® sales increased as a result of strong growth in both the United States and international markets. Allergan believes its worldwide market share is over 80% for medical neurotoxins including *Botox*®. Although the market for neurotoxins continues to expand, the rate of growth of *Botox*® was slightly impacted by the introduction of a competing toxin in 2001. Skin Care sales increased primarily as a result of strong sales of *Tazorac*® in the United States where it is FDA approved to treat both psoriasis and acne. Contact Lens Care sales decreased by $31.6 million, or 10% from 2000 to 2001. Contact Lens Care sales in the United States decreased 13% between 2000 and 2001 primarily due to a decrease in sales of private-label cold-chemical one-bottle disinfection systems, peroxide-based disinfection systems, and ancillary products. International Contact Lens Care sales decreased 9%. Currency fluctuations had a negative impact on international sales of $17.3 million, or 7%, attributable to the weakening Japanese yen and euro vs. the dollar. At constant currency rates, international Contact Lens Care sales decreased $4.3 million, or 2%, primarily attributable to the decrease in sales of peroxide-based disinfection and ancillary products partially offset by an increase in sales of the Company s one-bottle cold-chemical disinfection system, *Complete*®.

Net sales for 2000 were $1.563 billion, which was an increase of $156.4 million or 11% over 1999. Foreign currency fluctuations in 2000 decreased sales by $42.6 million or 3% as compared to average exchange rates in effect in 1999. At constant currency rates, sales increased by $199.0 million or 14% over 1999.

Net sales increased in 2000 compared to 1999 primarily as a result of increases in sales in three product lines, partially offset by a decrease in sales of Contact Lens Care products. Eye Care Pharmaceutical sales increased by $104.1 million, or 18%; sales of *Botox*® increased by $63.7 million, or 36%; and Ophthalmic Surgical sales increased by $27.5 million, or 12% in 2000. Eye Care Pharmaceutical sales increased primarily as a result of growth in sales of *Alphagan*® ophthalmic solution. Sales growth in international markets decreased due to currency, by $19.3 million, or 8%, primarily as a result of a decrease in the value of the euro compared to the dollar. Sales increased by 28% in the United States and 14% at constant currency rates in international markets in 2000 compared to 1999. *Botox*® sales increased as a result of strong growth in both the United States and international markets. Ophthalmic Surgical sales increased primarily as a result of strong sales of Allergan s *Sensar*® acrylic intraocular lens (IOL), silicone IOLs, and phacoemulsification equipment. Such increases were partially offset by a decrease in sales of PMMA IOLs. Contact Lens Care sales decreased by $31.0 million, or 9% from 1999 to 2000. While Contact Lens Care sales in the United States were consistent between 1999 and 2000, international sales decreased 11%. Currency fluctuations had a negative impact of $10.7 million, or 4%, attributable to the weakening euro vs. the dollar somewhat offset by the strengthening of the Japanese yen vs. the dollar. At constant currency rates, international Contact Lens Care sales decreased $19.7 million, or 7%, primarily attributable to the decrease in sales of peroxide-based disinfection and ancillary products as consumers increased their use of lower priced one-bottle cold-chemical disinfection systems.

The following table sets forth, for the periods indicated, net sales by geographic segment.

(in millions)	Year Ended December 31, 2001	2000	1999
United States	$928.1	$803.8	$669.2
Europe	344.5	354.9	377.1
Asia Pacific	239.2	233.8	211.3
Other	168.5	166.3	141.7
Segments total			

1,680.3	1,558.8	1,399.3
Manufacturing operations		
4.9	3.8	6.9
Total Product Net Sales		
$1,685.2	$1,562.6	$1,406.2

Table of Contents

Net sales increased in 2001 by $179.8 million on a constant currency basis, offset by a decrease in net sales of $57.2 million caused by changes in exchange rates. United States net sales increased $124.3 million. Net sales in Europe decreased $10.4 million primarily attributable to the weakening of the euro vs. the dollar as sales in constant currency were consistent between 2000 and 2001. Asia Pacific net sales increased $29.8 million at constant currency rates, somewhat offset by a $24.4 million decrease from the weakening of the Japanese yen vs. the dollar. Net sales in the Other geographic segment increased by $22.6 million at constant currency rates, substantially offset by a $20.4 million decrease resulting from the weakening of the Brazilian real vs. the dollar. The currency weakness of $57.2 million in 2001 primarily impacted the Eye Care Pharmaceutical and Contact Lens Care businesses. The Eye Care Pharmaceutical business was impacted by the weakening Brazilian real and euro, while the Contact Lens Care business was impacted by the weakening of the Japanese yen and the euro.

Net sales increased in 2000 by $199.0 million on a constant currency basis, offset by a decrease in net sales of $42.6 million caused by changes in exchange rates. United States net sales increased $134.6 million. Net sales in Europe increased $22.6 million at constant currency rates, but was more than offset by a $44.8 million decrease resulting from a weakening of the euro vs. the dollar. Asia Pacific net sales increased $19.7 million at constant currency rates. Net sales in the Other geographic segment increased by $25.2 million at constant currency rates. The currency weakness in 2000 primarily impacted the Eye Care Pharmaceutical and Contact Lens Care businesses, and resulted from the weakening of the euro. In addition, the strengthening of the Japanese yen somewhat offset the effects of the weakening euro in the Contact Lens Care business.

Income and Expenses

The following table sets forth the relationship to sales of various income statement items:

	Year Ended December 31,		
	2001	2000	1999
Product net sales	100.0%	100.0%	100.0%
Cost of sales	24.3	27.5	28.9
Product gross margin	75.7	72.5	71.1
Research services margin	0.2	0.2	0.2
Other operating costs and expenses:			
Selling, general and administrative	41.8	41.5	41.8
Technology fees from related party	(0.1)	(0.2)	(0.4)
Research and development	15.2	12.5	12.0
Restructuring charge reversal	(0.1)	(0.1)	(0.7)
Asset write-off reversal			(0.1)

Operating income	19.1	19.0	18.7
Gains/(loss) on investments, net	(0.3)	0.1	1.0
Unrealized gains on derivative instruments	0.4		
Contribution to The Allergan Foundation		(0.5)	
Other non-operating income (expense), net	0.8	0.3	(0.1)
Earnings before income taxes and minority interest	20.0%	19.4%	19.1%
Net earnings	13.3%	13.8%	13.4%

Gross Margin

The Company s gross margin percentage increased by 3.2 percentage points from 72.5% in 2000 to 75.7% in 2001 and by 1.4 percentage points from 71.1% in 1999 to 72.5% in 2000. The increases in gross margin percentage in both years were primarily the result of shifts in the product mix of sales. Higher margin Eye Care Pharmaceutical and *Botox*® sales represented a greater percentage of 2001 sales compared to 2000, and 2000 sales compared to 1999.

Table of Contents

Selling, General and Administrative

Selling, general and administrative expenses as a percentage of net sales increased in 2001 to 41.8% from 41.5% in 2000. The percentage increase in 2001 was the result of an increase in promotion, selling, marketing, and general and administrative expenses in both dollars and as a percentage of sales. This increase was primarily attributable to increased selling expenses associated with the launch of *Lumigan*® and *Alphagan*® *P* in the United States. Selling, general and administrative expenses as a percentage of net sales decreased in 2000 to 41.5% from 41.8% in 1999. The percentage decrease in 2000 was the result of an increase in promotion, selling, and marketing expenses, which were more than offset by a decrease in general and administrative expenses as a percentage of sales.

Research and Development

Research and development expenses increased by 31% in 2001 to $256.5 million compared to $195.6 million in 2000 and $168.4 million in 1999. Research and development spending does not include research and development spending performed under contracts with Allergan Specialty Therapeutics, Inc. (ASTI) in 2001, 2000, and 1999 or with Bardeen Sciences Corporation, LLC (See Note 6 to the Consolidated Financial Statements), in 2001.

In April 2001, the Company purchased all of the outstanding Class A Common Stock of ASTI for $71.0 million in cash. This resulted in a charge of $40.0 million associated with in-process research and development and the recording of $31.0 million in capitalized core technology. Excluding the effect of the $40.0 million charge, research and development expenses would have increased $20.9 million or 11%, compared to 2000. Research and development spending increased in 2001 as a result of the Company s expanded research efforts, particularly in technologies not currently commercialized by the Company, as well as Skin Care and *Botox*® research and development. Research and development spending increased in 2000 as a result of the expanded research efforts in Eye Care Pharmaceutical and *Botox*® research and development. Research and development expenditures are allocated to each product line, with higher rates of investments allocated to Eye Care Pharmaceuticals and *Botox*®.

Special Charges

During 1998, the Company recorded a $74.8 million restructuring charge, $50.9 million after taxes. The restructuring charge represented the costs of a comprehensive plan to streamline operations and reduce costs through reductions in global general and administrative (G&A) staff and the closure of five of ten manufacturing facilities in connection with the outsourcing and consolidation of manufacturing operations. In addition, operations in many countries were transferred to distributors, and business activities were concentrated into regional shared service centers. The changes in operations were expected to result in a net workforce reduction of 695 positions over a three-year period. The reductions in G&A staff and manufacturing facilities are primarily the result of a strategic assessment of the Company s product lines and businesses and a review of the G&A cost structure and manufacturing capabilities during 1998. During the years ended December 31, 2001, 2000 and 1999, severance payments of $3.0 million, $4.0 million and $8.5 million, respectively, were made to 121, 20 and 323 terminated employees, respectively, associated with the reduction of G&A staff and manufacturing facilities.

In 1999, the Company determined that various restructuring activities were completed for less cost than estimated in 1998, primarily as a result of lower than anticipated severance costs. A total of 95 positions included in the 695 position reduction did not require severance payments as certain employees terminated their employment prior to the date they would have qualified for severance, and other employees transferred to unfilled positions in other areas. As a result, the Company recorded a $3.8 million reduction in the restructuring plan in 1999.

In 2001, the Company reviewed all restructuring activities related to the 1998 restructuring charge and determined that all activities were completed. As a result, the remaining accrual of $1.7 million representing primarily an accrual for severance and facility closure costs was eliminated. There will be no further activities related to the 1998 restructuring plan.

Table of Contents

The following table presents the restructuring activities through December 31, 2001 resulting from the 1998 restructuring charge (in millions):

	Payments to Employees Involuntarily Terminated	Facility Closure and Consolidation Costs	Abandonment of Computer Software Costs	Other Costs	Total Restructuring
Net charge during 1998	$ 22.7	$ 28.9	$ 10.6	$ 12.6	$ 74.8
Assets written off during 1998		(25.3)	(10.6)	(4.8)	(40.7)
Spending during 1998	(3.6)		(7.4)		(11.0)
Balances as of December 31, 1998	19.1	3.6	0.4		23.1
Adjustments during 1999		(0.3)		0.3	
Net credit during 1999	(2.6)	(0.7)		(0.5)	(3.8)
Assets written off during 1999		(0.3)			(0.3)
Spending during 1999	(8.5)	(0.4)			(8.9)
Balances as of December 31, 1999	8.0	1.9	0.2		10.1
Adjustments during 2000	(0.5)	0.4		0.1	
Spending during 2000	(4.0)		(0.1)		(4.1)

Balances as of December 31, 2000	3.5	2.3	0.2	6.0
Net credit during 2001	(0.5)	(1.2)		(1.7)
Spending during 2001	(3.0)	(1.1)	(0.2)	(4.3)
Balances as of December 31, 2001	$	$	$	$

In 1998, management also completed a critical review of its asset bases in light of the strategic decisions made in the restructuring activities discussed above. Management made business decisions relating to the future use of certain assets resulting in a reassessment of the carrying value of such assets. As a result, the Company recorded a $58.5 million charge, $41.1 million after taxes. Such charge reduced the value of a manufacturing facility, office facilities in Europe, assets related to certain skin care products and certain other assets. In 1999, the Company realized $1.4 million in proceeds in excess of estimates from disposal of certain real property included in the 1998 asset write-off. As a result, the Company recorded a $1.4 million reduction in the asset write-off charge in 1999.

In 1996, the Company recorded a $70.1 million restructuring charge to streamline operations and reduce costs through management restructuring and facilities consolidation. The Company began restructuring activities in Europe in 1996 and completed them in 1999. In 1999, the Company determined that severance costs of positions eliminated would be $5.8 million less than accrued in 1996. As a result, the Company recorded a $5.8 million reduction in the restructuring charge in 1999. In 2000, the Company completed all restructuring activities related to the 1996 restructure charge and eliminated the remaining accrual of $2.0 million.

Operating Income

Operating income was $321.1 million or 19% of product net sales in 2001, $296.4 million or 19% of product net sales in 2000, and $263.5 million or 19% of product net sales in 1999.

Operating income increased by $24.7 million from $296.4 million or 19% of product net sales in 2000 to $321.1 million or 19% of product net sales in 2001. Such increases were the result of the $122.6 million or 8% increase in product sales, combined with the 3.2 percentage point increase in gross margin percentage from 2000 to 2001. Such increases were partially offset by the $56.3 million increase in selling, general, and administrative expenses, net of technology fees from a related party, and by the increase in research and development expenses of $60.9 million.

Operating income and operating income percentage increased by $32.9 million from $263.5 million or 19% of product net sales in 1999 to $296.4 million or 19% of product net sales in 2000. Such increases were the result of the $156.4 million or 11% increase in product net sales, combined with the 1.4 percentage point increase in gross margin percentage from 1999 to 2000. Such increases were partially offset by the $65.2 million increase in selling, general, and administrative expenses, net of technology fees from related party, and by the increase in research and development expenses of $27.2 million.

Table of Contents

The following table presents operating income by geographic operating segment:

	Operating Income		
(in millions)	2001	2000	1999
United States	$438.2	$342.9	$264.3
Europe	89.8	96.6	113.4
Asia Pacific	52.3	44.9	24.1
Other	36.9	30.9	29.2
Segments total	617.2	515.3	431.0
Manufacturing operations	126.2	97.0	95.0
Research and development	(256.5)	(195.6)	(168.4)
Research services margin	4.2	3.5	2.9
Restructuring charge reversal	1.7	2.0	9.6
Asset write-off reversal			1.4
Elimination of inter-company profit	(190.1)	(152.6)	(150.6)
General corporate	18.4	26.8	42.6
Operating income	$321.1	$296.4	$263.5

The Company operates in regions or geographic operating segments. The United States information is presented separately as it is the Company s headquarters country, and U.S. sales represented 55.4%, 51.7% and 48.1% of total product net sales in 2001, 2000, and 1999, respectively. In the United States, sales to one major customer represented 10%, 9% and 8% of total product sales in 2001, 2000 and 1999, respectively. No other country, or single customer, generates over 10% of total product net sales. Operations for the Europe Region also include sales to customers in Africa and the Middle East, and operations in the Asia Pacific Region include sales to customers in Australia and New Zealand.

Operating income attributable to each operating segment is based upon the management assignment of costs to such regions, which includes the manufacturing standard cost of goods produced by the Company s manufacturing operations (or the cost to acquire goods from third parties), freight, duty and local distribution costs, and royalties. Operating income for all operating segments and manufacturing operations also includes a charge for corporate services and asset utilization which permits management to better measure segment performance by including a cost of capital in the determination of operating income for each segment.

Income from manufacturing operations is not assigned to geographic regions because most manufacturing operations produce products for more than one region. Research and development costs are corporate costs. For the years ended December 31, 2001, 2000 and 1999, corporate costs also include the reduction of costs related to the reversal of special charges for restructuring and asset write-offs.

Operating income in the United States increased by $95.3 million, or 28%, from $342.9 million in 2000 to $438.2 million in 2001. Such increase was primarily the result of the 15% net sales increase in the United States combined with the impact of a higher gross margin percentage in 2001. The higher gross margin is attributable to the shifts in the product mix of sales to higher margin Eye Care and Skin Care Pharmaceutical and *Botox*® sales. Operating income in the Europe segment decreased by $6.8 million, or 7% in 2001 compared to 2000. Such decrease was primarily the result of the 3% decrease in Europe net sales combined with an increase in promotion, selling, and marketing costs as a percentage of net sales. This was somewhat offset by the impact of a higher European gross margin percentage and a decrease of general and administrative expenses as a percentage of sales in 2001. Operating income in the Asia Pacific segment increased by $7.4 million, or 16% in 2001 compared to 2000. This increase was primarily the result of the 2% increase in Asia Pacific sales combined with the impact of a higher gross margin percentage and the leveraging of promotion, selling, and marketing expenses as a percentage of sales in 2001. Operating income in the Other segment increased by $6.0 million, or 19%, in 2001 compared to 2000 primarily as a result of the 1% increase in sales combined with the impact of a higher gross margin percentage. This was somewhat offset by an increase in selling, general and administrative expenses in 2001. Operating income from Manufacturing Operations increased by $29.2 million, or 30%, in 2001 compared to 2000 primarily as a result of an increase in gross margins from intercompany sales to other geographic segments at intercompany transfer prices.

Table of Contents

Operating income in the United States increased by $78.6 million, or 30%, from $264.3 million in 1999 to $342.9 million in 2000. Such increase was primarily the result of the 20% increase in United States net sales combined with the impact of a higher gross margin percentage and the leveraging of selling, general, and administrative expenses as a percentage of sales in 2000. Operating income in the Europe segment decreased by $16.8 million, or 15%, in 2000 compared to 1999. Such decrease was primarily the result of the 6% decrease in Europe net sales combined with a decrease in gross margin percentage attributable to the weakening of the euro vs. the dollar. Operating income in the Asia Pacific segment increased by $20.8 million, or 86% in 2000 compared to 1999. Such increase was primarily the result of the 11% increase in Asia Pacific sales combined with the impact of a higher gross margin percentage and the leveraging of selling, general, and administrative expenses as a percentage of sales in 2000. Operating income in the Other geographic segment increased by $1.7 million, or 6%, in 2000 compared to 1999 primarily as a result of the 17% increase in sales somewhat offset by an increase in selling, general and administrative expenses in 2000.

Income Taxes

The effective tax rate in 2001 was 32.5%, up from the 29.0% effective tax rate in 2000. Included in the 2001 operating income is the $40.0 million charge for in-process research and development associated with the acquisition of ASTI in the second quarter of 2001. The Company did not record an income tax benefit for this charge. Excluding the negative impact of the $40.0 million in-process research and development charge, the 2001 effective tax rate would have been 28.3%, which is down slightly from the 2000 effective tax rate of 29.0% and is primarily attributable to increased research and development tax credits.

The effective tax rate in 2000 was 29.0%, down from the 30.0% effective tax rate in 1999. The decline in 2000 was primarily attributable to increased research and development tax credits coupled with a decrease in foreign dividends.

Net Earnings

Net earnings were $224.9 million in 2001 compared to $215.1 million in 2000. The $9.8 million increase in net earnings in 2001 is primarily the result of the $24.7 million increase in operating income and an increase in non-operating income of $5.4 million, including the pre-tax effect of the adoption of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, somewhat offset by an increase in income taxes of $20.3 million. Included in operating income is the $40.0 million charge for in-process research and development associated with the acquisition of ASTI in the second quarter of 2001. The Company did not record an income tax benefit for this charge. The increase in non-operating income includes a $5.1 million increase in net interest income, a $3.4 million unrealized gain on derivative instruments, net of the pre-tax effect of the adoption of SFAS No. 133, and a $3.1 million increase in Other, net. These increases were somewhat offset by a $5.2 million loss in 2001 associated with the permanent impairment of certain equity investments compared to a $1.0 million gain on investments in 2000. The increase in net interest income is associated with the full year effect of the issuance of Zero Coupon Convertible Subordinated Notes in November 2000. The net unrealized gain on derivative instruments relates to the mark to market adjustment required under SFAS No. 133, as well as the cumulative loss associated with the initial adoption of SFAS No. 133 on January 1, 2001. The increase in Other, net in 2001 vs. 2000 is primarily attributable to income associated with the mutual termination of a selling alliance agreement and the gain from the divestiture of certain pharmaceutical products in Latin America.

Net earnings were $215.1 million in 2000 compared to $188.2 million in 1999. The $26.9 million increase in net earnings in 2000 is primarily the result of the $32.9 million increase in operating income and an increase in non-operating income of $1.9 million, offset by an increase in income taxes of $7.4 million. The increase in non-operating income includes a $4.9 million increase in net interest income associated with the issuance of Zero Coupon Convertible Subordinated Notes in November of 2000, the absence of contributions to The Allergan Foundation of $6.9 million and a decrease in gain on investments of $13.0 million in 2000 vs. 1999.

Table of Contents

Liquidity And Capital Resources

Management assesses the Company s liquidity by its ability to generate cash to fund its operations. Significant factors in the management of liquidity are: funds generated by operations; levels of accounts receivable, inventories, accounts payable and capital expenditures; the extent of the Company s stock repurchase program; adequate lines of credit; and financial flexibility to attract long-term capital on satisfactory terms.

Historically, the Company has generated cash from operations in excess of working capital requirements. The net cash provided by operating activities was $361.2 million in 2001 compared to $354.1 million in 2000 and $254.3 million in 1999. Operating cash flow increased in 2001 compared to 2000 primarily as a result of the increase in net earnings. The increased cash outflow in Other related to various collaborations and other miscellaneous receivables which were offset by a decrease in cash used for trade receivables compared to 2000. Additionally, the increased cash outflow in Accrued Expenses is primarily the result of the Company s payment of its pension obligation of approximately $33 million. Operating cash flow increased in 2000 compared to 1999 primarily as a result of the increase in net earnings and an increase in accrued expenses, offset by the increase in accounts receivable.

Net cash used in investing activities was $176.8 million in 2001. Excluding the $70.2 million in net cash paid in connection with the acquisition of Allergan Specialty Therapeutics, Inc., (ASTI), cash used in investing activities would have been $106.6 million. The Company invested $89.9 million in expenditures for plant and equipment more fully described under *Capital Expenditures* below. Net cash used in investing activities was $85.3 million in 2000 including $66.9 million in expenditures for plant equipment and $8.0 million to acquire software. Net cash used in investing activities was $53.0 million in 1999 including $63.3 million in expenditures for plant and equipment, and $21.0 million to acquire software. Such expenditures in 1999 were offset by $33.8 million in proceeds from sale of investments.

Net cash used in financing activities was $170.6 million in 2001, composed primarily of $47.5 million for payment of dividends and $130.9 million for purchases of treasury stock. Cash was provided by $30.9 million from the sale of stock to employees. Net cash provided by financing activities was $345.8 million in 2000, composed primarily of proceeds from subordinated convertible borrowings of $400.0 million and $148.1 million from the sale of stock to employees. Net cash was used for the payment of dividends of $41.9 million, $122.8 million for purchases of treasury stock and $81.4 million in net repayments of debt, including notes payable, commercial paper and long-term debt. Net cash used in financing activities was $213.4 million in 1999, composed primarily of $37.0 million for payment of dividends, $225.3 million for purchases of treasury stock, and $2.7 million in repayments of long-term debt. Cash was provided by $22.8 million in long-term debt borrowings and $28.8 million from the sale of stock to employees.

As of December 31, 2001, the Company had long-term credit facilities and a medium term note program. The credit facilities allow for additional borrowings of up to $299.4 million through 2002 and $288.0 million through 2003. The note program allows the Company to issue up to an additional $35.0 million in notes on a non-revolving basis. Borrowings under the credit facilities are subject to certain financial and operating covenants, including a requirement that the Company maintain certain financial ratios and other customary covenants for credit facilities of similar kind. In connection with the AMO spin-off, the Company will work with its lenders to revise, if required, its financial covenants in order to remain in compliance with its credit agreements. As of December 31, 2001, the Company had $49.4 million in borrowings from certain credit facilities, primarily yen dominated facilities, and $75.0 million under the note program.

A substantial portion of the Company s existing cash and equivalents are held by non-U.S. subsidiaries. These funds are planned to be utilized in the Company s operations outside the United States. The Company has approximately $611.3 million in unremitted earnings outside the United States for which withholding and U.S. taxes have not been provided. Tax costs could be incurred if these funds were remitted to the United States.

The Company believes that the net cash provided by operating activities, supplemented as necessary with borrowings available under the Company s existing credit facilities and existing cash and cash equivalents, will

Table of Contents

provide it with sufficient resources to meet working capital requirements, debt service and other cash needs over the next year.

As described in Note 7 to the Consolidated Financial Statements, the Company estimates that over the next three to five years spending on various in-process research and development projects associated with the capitalized core technology in conjunction with the acquisition of ASTI, will range between $40 million and $80 million. The specific amount of spending will be determined annually based on the availability of research funds in conjunction with the Company s planned level of research and development in the normal course of business.

Capital Expenditures

Expenditures for property, plant and equipment totaled $89.9 million for 2001, $66.9 million for 2000 and $63.3 million for 1999. Expenditures in 2001 include construction of a new research and development facility, expansion of manufacturing facilities and a variety of other projects designed to improve productivity. The Company expects to invest $100 million to $110 million in a new research and development facility and property, plant and equipment in 2002.

Inflation

Although at reduced levels in recent years, inflation continues to apply upward pressure on the cost of goods and services used by the Company. The competitive and regulatory environments in many markets substantially limit the Company s ability to fully recover these higher costs through increased selling prices. The Company continually seeks to mitigate the adverse effects of inflation through cost containment and improved productivity and manufacturing processes.

Foreign Currency Fluctuations

Approximately 44.6% of the Company s revenues in 2001 were derived from operations outside the U.S., and a portion of the Company s international cost structure is denominated in currencies other than the U.S. dollar. As a result, the Company is subject to fluctuations in sales and earnings reported in U.S. dollars as a result of changing currency exchange rates. The Company routinely monitors its transaction exposure to currency rates and implements certain economic hedging strategies to limit such exposure, as appropriate. The impact of foreign currency fluctuations on the Company s sales was as follows: a $57.2 million decrease in 2001, a $42.6 million decrease in 2000 and a $34.6 million decrease in 1999. The 2001 sales decrease included decreases of $19.6 million related to the Japanese yen, $18.1 million related to the Brazilian real and $11.5 million related to European currencies. The 2000 sales decrease included decreases of $44.8 million related to the euro offset by an $2.8 million increase related to the Japanese yen. The 1999 sales decrease included decreases of $37.4 million related to the Brazilian real and $15.0 million related to European currencies, offset by an $18.6 million increase related to the Japanese yen. See Note 1 to the Consolidated Financial Statements relative to the Company s accounting policy on foreign currency translation.

In December 2001, the Argentine peso devalued and decoupled from the U.S. dollar. While the Company does not have significant operations in Argentina, as net sales and net assets represent less than 1% of the Company s total, the Company could be subject to foreign currency translation losses.

In the normal course of business, operations of the Company are exposed to risks associated with fluctuations in interest rates and foreign currency exchange rates. The Company addresses these risks through controlled risk management that includes the use of derivative financial instruments to economically hedge or reduce these exposures. The Company does not enter into financial instruments for trading or speculative purposes. See Note 14 to the Consolidated Financial Statements for activities relating to foreign currency and interest rate risk management.

Table of Contents

Bardeen Sciences Company, LLC

In April 2001, the Company contributed the rights to certain compounds and research projects (currently consisting of the following: Memantine, Androgen Tears, Tazarotene in oral form for the treatment of acne, AGN 195795, AGN 196923, AGN 197075, a hypotensive lipid/timolol combination, a photodynamic therapy project, tyrosine kinase inhibitors for the treatment of ocular neovascularization, a vision-sparing project, and a retinal disease project (the Portfolio)) to Bardeen Sciences Company, LLC (BSC) in exchange for future commercialization rights and a contingent call option (the Option). Under certain circumstances, additional compounds and projects may be added to the Portfolio. The Portfolio does not consist of proprietary basic technology necessary to the Company s ongoing operations. BSC was formed for the purpose of researching, developing and commercializing human pharmaceutical compounds and products. BSC is wholly owned by an independent third-party investor entity (the Investor) which has made, and retains, a substantive equity investment in BSC. Neither the Company nor any officer or director of the Company owns any interest in the Investor or any interest in BSC. The Investor has voting control of BSC and has the substantive risks and rewards of ownership of BSC. The Company has certain protective rights but maintains no operational control over BSC. An officer of the Company currently serves on the 5-member board of directors of BSC.

The commercialization rights, which are guaranteed through the expiration of the Option and exist at BSC's discretion thereafter, currently permit the Company to market products developed from the compounds contributed to BSC worldwide, subject to a market-rate royalty on net sales. In addition, the Company may, at any time before the Option expires, acquire a separate option to purchase rights to any one product for a payment of $25 million. The Company may exercise this option to buy non-exclusive royalty-free rights to any one product that has been approved for sale by the Food and Drug Administration (FDA) or other regulatory body at the then-current fair market value of such rights.

BSC has engaged the Company to perform certain research and development services for BSC. However, BSC has the right at any time and for any reason to terminate its research and development agreement with the Company and to use a third party research and development provider.

The Company s Option, if exercisable, would provide the Company with the right to buy all but not less than all of the Investor s equity in BSC for an option price described in the option agreement.

The Option is not currently exercisable. The Option will only become exercisable by the Company on the earlier of one of the following events:

1. The following two events have occurred: (i) the Portfolio has resulted in at least three research successes , as that term is defined in the option agreement and (ii) two (2) years have passed since the effective date of the option agreement; or

2. The amount of money provided by the Investor and available for research and development by BSC has either (i) fallen below an amount required to fund BSC s anticipated research and development activities during the next 90-day period or (ii) fallen below $15,000,001 (a Funding Shortfall); or

3. A change of law, regulation, or interpretive legal or accounting principles has occurred which could materially affect the Company s relationship with BSC.

The Investor s obligations to continue to fund BSC are affected by certain events, including the Company s ability to adequately perform research and development services for BSC, the Company s ability to meet its obligations, and changes of control of the Company. In the event that the Investor is relieved of its obligation to fund BSC as a result of any of the foregoing, a Funding Shortfall could occur and the exercisability of the Option could accelerate.

The Option expires if not exercised by the earlier of 5 years from the date of the parties agreement or 60 days after a Funding Shortfall.

Table of Contents

The Option price takes into account the amount of research and development funds expended at risk by BSC on the Portfolio and the time that has elapsed since the effective date of the parties option agreement. Although not currently exercisable, for illustrative purposes if the Company were able to exercise the Option as of December 31, 2001, the option price would be approximately $95 million. If BSC continues to fund research and development on the Portfolio at the level currently anticipated, and the Company exercised the Option on December 31, 2003, the option price would be approximately $350 million. Additionally, the option price would be greater in later years, as BSC expended additional funds on research and development.

Neither BSC nor the Investor has the ability to require the Company to exercise the Option or to require the Company to provide any funding to BSC, and the Company has not and does not intend to provide any funding to BSC. In the event the Company does not exercise the Option or its product purchase right, BSC has the ability to sell compounds or products to other third parties.

BSC s current Portfolio research and development activities take place under a Research and Development Services Agreement between the Company and BSC pursuant to which all such activities are fully funded by BSC. Because the financial risk associated with the research and development has been transferred to BSC and repayment of the funds provided by BSC depends solely on the results of the research and development having future economic benefit, the Company recognizes revenues and related costs as services are performed under such agreement as required under SFAS No. 68, *Research and Development Arrangements*. These amounts are included in research service revenues in the accompanying Consolidated Statements of Earnings. For the year ended December 31, 2001, the Company recognized $27.4 million and $25.0 million in research revenues and research costs, respectively, under the Research and Development Services Agreement with BSC.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

In the normal course of business, operations of the Company are exposed to risks associated with fluctuations in interest rates and foreign currency exchange rates. The Company addresses these risks through controlled risk management that includes the use of derivative financial instruments to economically hedge or reduce these exposures. The Company does not enter into financial instruments for trading or speculative purposes. See Note 14 to the Consolidated Financial Statements for activities relating to foreign currency and interest rate risk management.

To ensure the adequacy and effectiveness of the Company s interest rate and foreign exchange hedge positions, the Company continually monitors its interest rate swap positions and foreign exchange forward and option positions both on a stand-alone basis and in conjunction with its underlying interest rate and foreign currency exposures, from an accounting and economic perspective.

However, given the inherent limitations of forecasting and the anticipatory nature of the exposures intended to be hedged, there can be no assurance that such programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in either interest or foreign exchange rates. In addition, the timing of the accounting for recognition of gains and losses related to mark-to-market instruments for any given period may not coincide with the timing of gains and losses related to the underlying economic exposures and, therefore, may adversely affect the Company s consolidated operating results and financial position. The gains and losses realized from the foreign currency forward and option contracts are recorded in Other, net in the accompanying Consolidated Statements of Earnings.

In June 1998, Statement of Financial Accounting Standards No. 133 - Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133) was issued, as amended, and was effective for all periods of fiscal years beginning after June 15, 2000 (January 1, 2001 for the Company). SFAS No. 133 establishes accounting and reporting standards for all derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the statement of position and measure those instruments at fair value. SFAS No. 133 requires that changes in the derivative s fair value be recognized in earnings unless specific hedging accounting criteria are met. Accounting for qualifying hedges allows a derivative s gains and losses to offset related results on the hedged item in the income statement, and requires that an entity must formally document, designate and

Table of Contents

assess the effectiveness of derivative instruments that receive hedge accounting. The Company adopted SFAS No. 133 on January 1, 2001.

The Company identified three types of derivative instruments at December 31, 2000, which were recorded as Other current assets on the Company s Condensed Consolidated Balance Sheet at January 1, 2001, the date of adoption of SFAS No. 133. The derivative instruments are: interest rate swap agreements, foreign currency option contracts and foreign currency forward contracts. Upon adoption of SFAS No. 133, the Company s management decided not to designate the foreign currency option and foreign currency forward contracts as accounting hedges. Accordingly, the Company recorded a net-of-tax cumulative-effect loss of $1.8 million into earnings to adjust the foreign currency option and forward contracts to fair value at January 1, 2001.

Interest Rate Risk

The Company s interest income and expense is more sensitive to fluctuations in the general level of U.S. and Japan interest rates than to changes in rates in other markets. Changes in U.S. and Japan interest rates affect the interest earned on the Company s cash and equivalents, interest expense on the Company s debt as well as costs associated with foreign currency contracts.

The Company s exposure to market risk for changes in interest rates results from the Company s long-term debt obligations and related derivative financial instruments. During 2001, the Company held interest rate swap agreements to reduce the impact of interest rate changes on its floating rate long-term debt. These derivative financial instruments allowed the Company to hold long-term borrowings at floating rates and then swap them into fixed rates that are anticipated to be lower than those available to the Company if fixed-rate borrowings were made directly.

These swaps effectively converted the Company s floating-rate debt to fixed-rates and qualified for hedge accounting treatment. Since these interest rate swap agreements qualified as cash flow hedges under SFAS No. 133, changes in fair value of these swap agreements were recorded in other comprehensive income to the extent that such changes were effective and as long as the cash flow hedge requirements were met. Periodic interest payments and receipts on both the debt and swap agreement were recorded as components of interest expense in the accompanying Consolidated Statements of Earnings. The impact of interest rate risk management activities and cumulative deferred gains and losses recorded in Accumulated Other Comprehensive Income for the year ended December 31, 2001 were not material. At December 31, 2001 the Company did not have any interest rate swap agreements outstanding.

At December 31, 2001, the Company had $91.4 million of variable rate debt. If the interest rates on the variable rate debt were to increase or decrease by 1% for the year, annual interest expense would increase or decrease by approximately $900,000.

Table of Contents

The table below presents information about certain of the Company s investment portfolio and its debt obligations for the years ended December 31, 2001 and 2000:

DECEMBER 31, 2001

(in millions, except interest rates)	Maturing in 2002	2003	2004	2005	2006	Thereafter	Total	Fair Market Value
ASSETS								
Cash equivalents:								
Repurchase Agreements	$182.9						$182.9	***$182.9***
Weighted Average Interest Rate	2.16%						2.16%	
Foreign Time Deposits	51.9						51.9	***51.9***
Weighted Average Interest Rate	3.93%						3.93%	
Commercial Paper	386.3						386.3	***386.3***
Weighted Average Interest Rate	1.91%						1.91%	
Other Cash Equivalents	105.2						105.2	***105.2***
Weighted Average Interest Rate	2.23%						2.23%	
Total cash equivalents	***$726.3***						***$726.3***	***$726.3***
Weighted Average Interest Rate	***2.16%***						***2.16%***	
LIABILITIES								
Debt Obligations:								
Fixed Rate ($US)	$20.0	$30.0				$411.8	$461.8	***$461.2***
Weighted Average Interest Rate	6.92%	5.72%				2.50%	2.90%	
Fixed Rate (JPY)	19.0	$37.8				56.8	***59.1***	
Weighted Average Interest Rate	3.55%	1.85%				2.42%		
Other Fixed Rate (non-US$)	4.2	0.4	$0.1			4.7	***4.7***	
Weighted Average Interest Rate	16.85%	12.85%	12.00%			16.41%		
Variable Rate ($US)	29.7	1.4				31.1	***31.1***	
Weighted Average Interest Rate	3.41%	1.93%				3.34%		
Variable Rate (JPY)	19.0	19.0				38.0	***38.0***	
Weighted Average Interest Rate	0.75%	0.58%				0.67%		

Other Variable Rate (non-US$)						
21.2	0.7	0.4		22.3	***22.3***	
Weighted Average Interest Rate						
4.06%	5.10%	5.10%		4.11%		
Total Debt Obligations						
$94.1	***$70.5***	***$0.5***	***$37.8***	***$411.8***	***$614.7***	***$616.4***
Weighted Average Interest Rate						
4.37%	***3.71%***	***6.48%***	***1.85%***	***2.50%***	***2.89%***	

Table of Contents

DECEMBER 31, 2000

(in millions, except