

ALLERGAN INC
Form 10-Q
November 01, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 24, 2004

OR

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

COMMISSION FILE NUMBER 1-10269

ALLERGAN, INC.

(Exact name of Registrant as Specified in its Charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

95-1622442
(I.R.S. Employer
Identification No.)

2525 DUPONT DRIVE, IRVINE, CALIFORNIA
(Address of Principal Executive Offices)

92612
(Zip Code)

(714) 246-4500
(Registrant's Telephone Number,
Including Area Code)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

As of October 22, 2004 there were 134,254,772 shares of common stock outstanding (including 2,967,635 shares held in treasury).

ALLERGAN, INC.
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 24, 2004

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Allergan, Inc.

Unaudited Condensed Consolidated Statements of Earnings
(in millions, except per share amounts)

	Three months ended		Nine months ended	
	Sept. 24, 2004	Sept. 26, 2003	Sept. 24, 2004	Sept. 26, 2003
<i>Product Sales</i>				
Net sales	\$ 510.8	\$ 443.3	\$1,489.4	\$1,276.0
Cost of sales	99.1	82.8	282.9	231.3
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Product gross margin	411.7	360.5	1,206.5	1,044.7
<i>Research services</i>				
Research service revenues				16.0
Cost of research services				14.5
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Research services margin				1.5
Operating costs and expenses				
Selling, general and administrative	195.5	171.1	572.8	526.2
Research and development	83.0	81.0	257.6	492.6
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Operating income	133.2	108.4	376.1	27.4
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
<i>Non-operating income (expense)</i>				
Interest income	2.6	2.6	6.8	10.7
Interest expense	(6.8)	(3.9)	(14.2)	(12.2)
Unrealized gain (loss) on derivative instruments, net	(0.1)	0.1	0.1	(0.9)
Gain on investments, net		0.2		
Other, net	3.6	(1.0)	2.3	(1.6)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	(0.7)	(2.0)	(5.0)	(4.0)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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Earnings before income taxes and minority interest	132.5	106.4	371.1	23.4
Provision (benefit) for income taxes	40.3	29.8	105.8	(16.2)
Minority interest expense	0.2	0.6	0.7	1.3
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net earnings	\$ 92.0	\$ 76.0	\$ 264.6	\$ 38.3
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Earnings per share:				
Basic	\$ 0.70	\$ 0.58	\$ 2.02	\$ 0.29
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted	\$ 0.70	\$ 0.57	\$ 1.99	\$ 0.29
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

See accompanying notes to unaudited condensed consolidated financial statements.

Allergan, Inc.

Unaudited Condensed Consolidated Balance Sheets
(in millions, except share data)

	September 24, 2004	December 31, 2003
	<u> </u>	<u> </u>
ASSETS		
Current assets:		
Cash and equivalents	\$ 778.9	\$ 507.6
Trade receivables, net	262.0	220.1
Inventories	84.8	76.3
Other current assets	111.5	124.2
	<u> </u>	<u> </u>
Total current assets	1,237.2	928.2
Investments and other assets	216.7	210.9
Deferred tax assets	128.5	118.6
Property, plant and equipment, net	448.2	422.5
Goodwill	8.4	8.4
Intangibles, net	60.2	66.3
	<u> </u>	<u> </u>
Total assets	<u>\$ 2,099.2</u>	<u>\$ 1,754.9</u>
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable	\$ 21.6	\$ 24.4
Accounts payable	97.3	87.2
Accrued expenses	251.6	225.3
Income taxes	55.2	46.5
	<u> </u>	<u> </u>
Total current liabilities	425.7	383.4
Long-term debt	56.3	66.0
Long-term convertible notes, net of discount	512.0	507.3
Other liabilities	105.2	77.1
Commitments and contingencies		
Minority interest	2.5	2.5

See accompanying notes to unaudited condensed consolidated financial statements.

Allergan, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows
(in millions)

	Nine months ended	
	September 24, 2004	September 26, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	\$ 264.6	\$ 38.3
Non-cash items included in earnings:		
Depreciation and amortization	50.5	41.7
In-process research and development		278.8
Amortization of original issue discount and debt issuance costs	9.4	6.2
Deferred income taxes (benefit)	(9.5)	(99.8)
Loss on investments and disposal of fixed assets	3.4	1.4
Unrealized (gain) loss on derivative instruments	(0.1)	0.9
Expense of compensation plans	7.9	6.7
Minority interest expense	0.7	1.3
Changes in assets and liabilities:		
Trade receivables	(43.2)	(8.2)
Inventories	(8.6)	(1.4)
Other current assets	11.3	(4.0)
Accounts payable	10.3	1.5
Accrued expenses and other liabilities	57.6	33.9
Income taxes	34.7	10.8
Other non-current assets	(13.9)	(16.3)
	<u>375.1</u>	<u>291.8</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(64.0)	(62.0)
Acquisition, net of cash acquired		(251.8)
Other, net	(6.4)	(10.9)
	<u>(70.4)</u>	<u>(324.7)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Dividends to stockholders	(35.5)	(35.2)
Net repayments under commercial paper obligations	(10.4)	
Net (repayments) borrowings of notes payable	(2.7)	6.6

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Sale of stock to employees	80.0	39.9
Payments to acquire treasury stock	(65.2)	(37.4)
	<u> </u>	<u> </u>
Net cash used in financing activities	(33.8)	(26.1)
	<u> </u>	<u> </u>
Effect of exchange rate changes on cash and equivalents	0.4	8.2
	<u> </u>	<u> </u>
Net increase (decrease) in cash and equivalents	271.3	(50.8)
Cash and equivalents at beginning of period	507.6	774.0
	<u> </u>	<u> </u>
Cash and equivalents at end of period	\$ 778.9	\$ 723.2
	<u> </u>	<u> </u>
Supplemental disclosure of cash flow information		
Cash paid for:		
Interest (net of capitalization)	\$ 7.3	\$ 13.0
	<u> </u>	<u> </u>
Income taxes, net of refunds	\$ 79.4	\$ 45.0
	<u> </u>	<u> </u>

See accompanying notes to unaudited condensed consolidated financial statements.

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary (consisting only of normal recurring accruals) to present fairly the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP) for annual periods and should be read in conjunction with the Company's audited consolidated financial statements and related notes for the year ended December 31, 2003. The Company prepared the condensed consolidated financial statements following the requirements of the Securities and Exchange Commission for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted. The results of operations for the nine months ended September 24, 2004 are not necessarily indicative of the results to be expected for the year ending December 31, 2004 or any other period(s).

Reclassifications

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

Stock-Based Compensation

As allowed by Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, the Company has elected to continue to apply the intrinsic-value-based method of accounting. Under this method, the Company measures stock-based compensation for option grants to employees assuming that options granted at market price at the date of grant have no intrinsic value. The Company's contributions of common stock related to the Company's savings and investment plans are measured at market price at the date of contribution. Restricted stock awards are valued based on the market price of a share of nonrestricted stock on the grant date. No compensation expense has been recognized for stock-based incentive compensation plans other than for the contributions of common stock to the Company's savings and investment plans and the restricted stock awards under both the incentive compensation plan and the non-employee director equity incentive plan. Had compensation expense for the Company's stock options under the incentive compensation plan and the non-employee director equity incentive plan been recognized based upon the fair value of awards granted, the Company's net earnings would have been reduced to the following *pro forma* amounts:

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

	Three months ended		Nine months ended	
	September 24, 2004	September 26, 2003	September 24, 2004	September 26, 2003
(in millions, except per share amounts)				
Net earnings, as reported	\$ 92.0	\$ 76.0	\$264.6	\$ 38.3
Add stock-based compensation expense included in reported net earnings, net of tax	1.3	1.3	5.0	4.5
Deduct stock-based compensation expense determined under fair value based method, net of tax	(10.3)	(10.0)	(32.1)	(31.7)
<i>Pro forma</i> net earnings	\$ 83.0	\$ 67.3	\$237.5	\$ 11.1
Earnings per share:				
As reported basic	\$ 0.70	\$ 0.58	\$ 2.02	\$ 0.29
As reported diluted	\$ 0.70	\$ 0.57	\$ 1.99	\$ 0.29
<i>Pro forma</i> basic	\$ 0.63	\$ 0.52	\$ 1.81	\$ 0.09
<i>Pro forma</i> diluted	\$ 0.63	\$ 0.51	\$ 1.79	\$ 0.08

These *pro forma* effects are not indicative of future amounts. The Company expects to grant additional awards in future years.

2. Recently Adopted Accounting Standards

In October 2004, the Emerging Issues Task Force of the Financial Accounting Standards Board issued its consensus opinion on EITF Issue No. 04-8, *The Effect of Contingently Convertible Debt on Diluted Earnings Per Share* (EITF No. 04-8). The Task Force reached a consensus that contingently convertible debt instruments with embedded conversion features that are contingent upon market price triggers should be included in diluted earnings per share computations, if dilutive, regardless of whether the contingency has been met. The Company's currently outstanding zero coupon convertible senior notes due 2022 (Senior Notes) have an embedded conversion feature that is contingent upon a market price trigger. The Company will adopt the provisions of EITF No. 04-8 in the fourth quarter of 2004. Accordingly, the Company will restate diluted earnings per share for all prior periods based on the terms of the Senior Notes in place at the date of adoption. The Company estimates that the effect of adopting this accounting standard would increase the number of diluted shares used to calculate diluted earnings per share for the three month and nine month periods ended September 24, 2004 by 0.6 million and 1.2 million shares, respectively, and by 0.9 million and 0.5 million shares for the three and nine month periods ended September 26, 2003, respectively. Reported diluted earnings per share would decrease by \$0.01 and \$0.02 for the three and nine month periods ended September 24, 2004, and there would be no effect on reported diluted earnings per share for the comparable three and nine month periods ended September 26, 2003.

In December 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 132 (revised 2003), *Employers' Disclosure about Pensions and Other Postretirement Benefits* (SFAS No. 132 Revised), which revised employers' disclosures about pension plans and

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

other postretirement benefit plans. SFAS No. 132 Revised does not change the measurement or recognition of those plans required by Financial Accounting Standards Board Statements No. 87, *Employers Accounting for Pensions*, No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and No. 106, *Employers Accounting for Postretirement Benefits Other than Pensions*. SFAS No. 132 Revised retains the disclosure requirements contained in Financial Accounting Standards Board Statement No. 132, *Employers Disclosures about Pensions and Other Postretirement Benefits*, which it replaces. SFAS No. 132 Revised requires additional disclosures to those in the original statement about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The provisions of SFAS No. 132 Revised are effective for financial statements with fiscal years ending after December 15, 2003, with the exception of disclosure information regarding foreign pension plans and estimated future benefit payments, which provisions are effective for fiscal years ending after June 15, 2004.

As required by SFAS No. 132 Revised, the Company provided the additional disclosures about the assets, obligations, cash flows and net periodic benefit cost of its U.S. pension plans and other postretirement benefit plan for its fiscal year ended December 31, 2003, and elected early adoption and implemented the provisions regarding the disclosure information for its foreign pension plans for its fiscal year ended December 31, 2003. The Company does not expect to provide disclosure information regarding estimated future benefit payments until its fiscal year ending December 31, 2004.

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), which requires extensive disclosures and requires companies to evaluate variable interest entities to determine whether to apply the consolidation provisions of FIN 46 to those entities. Companies must apply FIN 46 to entities with which they are involved if the entity's equity has specified characteristics. If it was reasonably possible that a company had a significant variable interest in a variable interest entity at the date FIN 46's consolidation requirements became effective, the company must disclose the nature, purpose, size and activities of the variable interest entity and the consolidated enterprise's maximum exposure to loss resulting from its involvement with the variable interest entity in all financial statements issued after January 31, 2003 regardless of when the variable interest entity was created. The consolidation provisions of FIN 46, if applicable, applied to variable interest entities created after January 31, 2003 immediately, and to variable interest entities created before February 1, 2003 in a company's interim period beginning after June 15, 2003. The Company adopted the provisions of FIN 46 in the Company's third quarter of 2003. The adoption did not have a material effect on the Company's consolidated financial statements. In December 2003, the Financial Accounting Standards Board issued Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46 Revised). Under the new guidance of FIN 46 Revised, clarification regarding the

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

identification of variable interest entities is provided as well as how an enterprise should assess its interest in such a variable interest entity to determine whether it is to be consolidated. The Company adopted the provisions of FIN 46 Revised in the fourth quarter of 2003. The adoption did not have a material effect on the Company's consolidated financial statements.

3. Intangibles and Goodwill

At September 24, 2004 and December 31, 2003, the components of amortizable and unamortizable intangibles and goodwill and certain other related information were as follows:

<i>Intangibles</i>	September 24, 2004			December 31, 2003		
	Gross Amount	Accumulated Amortization	Weighted Average Amortization Period (in years)	Gross Amount	Accumulated Amortization	Weighted Average Amortization Period (in years)
(in millions)						
Amortizable Intangible Assets:						
Licensing	\$38.5	\$ (9.2)	7.9	\$38.5	\$ (4.9)	7.9
Trademarks	3.5	(1.8)	15.0	3.5	(1.6)	15.0
Core Technology	29.6	(1.6)	15.0	29.6	(0.2)	15.0
Other	1.0	(0.7)	5.0	1.0	(0.5)	5.0
	<u>72.6</u>	<u>(13.3)</u>	11.1	<u>72.6</u>	<u>(7.2)</u>	11.1
Unamortizable Intangible Assets:						
Foreign business license	<u>0.9</u>	<u>—</u>		<u>0.9</u>	<u>—</u>	
	<u>\$73.5</u>	<u>\$(13.3)</u>		<u>\$73.5</u>	<u>\$(7.2)</u>	

Licensing assets consist primarily of capitalized payments to third party licensors related to the achievement of regulatory approvals to commercialize products in specified markets and up-front payments associated with royalty obligations for products that have achieved regulatory approval for marketing. The core technology consists of a drug delivery technology acquired in connection with the acquisition of Oculex Pharmaceuticals, Inc. in November 2003.

Aggregate amortization expense for amortizable intangible assets for the quarters ended September 24, 2004 and September 26, 2003 was \$2.1 million and \$0.9 million, respectively, and \$6.2 million and \$2.2 million for the nine

month periods ended September 24, 2004 and September 26, 2003, respectively.

Estimated amortization expense is \$8.2 million for 2004 and 2005, \$7.9 million for 2006, \$6.8 million for 2007, \$4.9 million for 2008 and \$4.3 million for 2009.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Goodwill

(in millions)	September 24, 2004	December 31, 2003
Goodwill:		
United States	\$ 4.6	\$ 4.6
Latin America	3.0	3.0
Europe and Other	0.8	0.8
	<u> </u>	<u> </u>
	\$ 8.4	\$ 8.4
	<u> </u>	<u> </u>

There was no activity related to goodwill during the quarter or nine month period ended September 24, 2004.

4. Inventories

Components of inventories were:

(in millions)	September 24, 2004	December 31, 2003
Finished goods	\$ 47.8	\$ 38.3
Work in process	19.6	22.3
Raw materials	17.4	15.7
	<u> </u>	<u> </u>
Total	\$ 84.8	\$ 76.3
	<u> </u>	<u> </u>

5. Income Taxes

Income taxes are determined using an estimated annual effective tax rate, which is generally less than the U.S. Federal statutory rate, primarily because of lower tax rates in certain non-U.S. jurisdictions and research and development (R&D) tax credits available in the United States. The Company recognizes deferred tax assets and

liabilities for temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities, along with net operating loss and credit carryforwards. The Company records a valuation allowance against its deferred tax assets to reduce the net carrying value to an amount that it believes is more likely than not to be realized. When the Company establishes or reduces the valuation allowance against its deferred tax assets, its income tax expense will increase or decrease, respectively, in the period such determination is made. Included in the provision for income taxes for the nine months ended September 24, 2004 is an estimated \$6.1 million income tax benefit for previously paid state income taxes, which became recoverable due to a favorable state court decision that became final during the second quarter of 2004.

Valuation allowances against the Company's deferred tax assets were \$52.7 million at September 24, 2004 and \$62.6 million at December 31, 2003. The decrease in the amount of valuation allowances at September 24, 2004 compared to December 31, 2003 is primarily due to a change in the estimated amount of R&D tax credits that the Company believes will be realized during

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

the current year. The reduction to the valuation allowances recorded in the first nine months of 2004 is a component of the estimated annual effective tax rate. Material differences may result in an increase or decrease in the provision for income taxes if the actual amounts for valuation allowances required against deferred tax assets differ from the amounts estimated by management.

The Company has not provided for withholding and U.S. taxes for the unremitted earnings of certain non-U.S. subsidiaries because the Company has reinvested or expects to reinvest these earnings permanently in such operations. At December 31, 2003, the Company had approximately \$712 million in unremitted earnings outside the United States for which withholding and U.S. taxes were not provided. Tax expense would be incurred if these funds were remitted to the United States. It is not practicable to estimate the amount of the deferred tax liability on such unremitted earnings. Upon remittance, certain foreign countries impose withholding taxes that are then available, subject to certain limitations, for use as credits against the Company's U.S. tax liability. The Company annually updates its estimate of unremitted earnings outside the United States after the completion of each fiscal year.

On October 22, 2004, the American Jobs Creation Act of 2004 was enacted in the United States. The Company is currently evaluating the impact of this new law on its operations and effective tax rate. In particular, the Company is evaluating the law's provisions relating to incentives to reinvest foreign earnings in the United States, which require a domestic reinvestment plan to be created and approved by the Company's board of directors before executing any repatriation activities. The Company currently has no plans to change its policy regarding permanent reinvestment of unremitted earnings in its foreign operations. The Company is also evaluating allowable deductions, beginning in 2005, for income attributable to United States production activities. At this time, the Company is unable to determine the effects of this new law and will continue to analyze its potential impact as guidance is made available.

The Company and its domestic subsidiaries file a consolidated U.S. federal income tax return. Such returns have either been audited or settled through statute expiration through the year 1999. The Company and its consolidated domestic subsidiaries are currently under U.S. federal examination for years 2000 through 2002. The Company believes the additional tax liability for such years, if any, will not have a material effect on the financial position of the Company.

6. Employee Retirement and Other Benefit Plans

The Company sponsors various qualified defined benefit pension plans covering a substantial portion of its employees. In addition, the Company sponsors two supplemental nonqualified plans covering certain management employees and officers and one retiree health plan covering United States retirees and dependents.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Components of net periodic benefit cost for the three and nine month periods ended September 24, 2004 and September 26, 2003 were as follows:

(in millions)	Three months ended			
	Pension Benefits		Other Postretirement Benefits	
	September 24, 2004	September 26, 2003	September 24, 2004	September 26, 2003
	2004	2003	2004	2003
Service cost	\$ 3.8	\$ 3.3	\$ 0.2	\$ 0.3
Interest cost	5.9	5.3	0.3	0.3
Expected return on plan assets	(6.8)	(6.4)		
Amortization of prior service cost			(0.1)	(0.1)
Recognized net actuarial loss	1.9	0.8		
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net periodic benefit cost	<u>\$ 4.8</u>	<u>\$ 3.0</u>	<u>\$ 0.4</u>	<u>\$ 0.5</u>

(in millions)	Nine months ended			
	Pension Benefits		Other Postretirement Benefits	
	September 24, 2004	September 26, 2003	September 24, 2004	September 26, 2003
	2004	2003	2004	2003
Service cost	\$ 8.5	\$ 7.1	\$ 1.0	\$ 0.9
Interest cost	11.8	10.7	0.9	0.9
Expected return on plan assets	(13.8)	(12.7)		
Amortization of prior service cost	0.1	0.1	(0.2)	(0.1)
Recognized net actuarial loss	3.7	1.7		
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net periodic benefit cost	<u>\$ 10.3</u>	<u>\$ 6.9</u>	<u>\$ 1.7</u>	<u>\$ 1.7</u>

In 2004, the Company expects to pay contributions of between \$13.6 million and \$15.6 million to its U.S. and non-U.S. pension plans and between \$0.6 million and \$0.7 million to its other postretirement plan.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) expands Medicare coverage, primarily by adding a voluntary prescription drug benefit for Medicare-eligibles starting in 2006. The Act provides employers currently sponsoring prescription drug programs for Medicare-eligibles with a range of options for coordinating with the new government-sponsored prescription drug program to potentially reduce program costs. These options include supplementing the government program on a secondary payer basis or accepting a direct subsidy from the government to support a portion of the cost of the employer's program. Financial Accounting Standards Board Position 106-1 (FASB Staff Position 106-1) allows the Company to begin recognizing any potential impact of the

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Act in its first quarter 2004 consolidated financial statements or to defer recognizing the potential impact until more definitive accounting guidance was provided. The Company chose to defer the implementation of FASB Staff Position 106-1 until more definitive accounting guidance was provided.

In May 2004, the Financial Accounting Standards Board released Financial Accounting Standards Board Position 106-2 (FASB Staff Position 106-2) to supercede FASB Staff Position 106-1 and to provide guidance on accounting and disclosure requirements related to the Act. FASB Staff Position 106-2 is effective for financial reporting periods beginning after June 15, 2004. The Company adopted FASB Staff Position 106-2 effective the beginning of its second quarter 2004 on a retroactive application to date of enactment basis as allowed by FASB Staff Position 106-2. In conjunction with the implementation of FASB Staff Position 106-2, the Company will receive the direct subsidy from the government. As a result of the adoption of FASB Staff Position 106-2, the Company's net periodic benefit cost was reduced by \$0.1 million for the nine months ended September 24, 2004 and its accumulated projected benefit obligation was reduced by \$2.3 million. The reduction in accumulated benefit obligation will be accounted for as an actuarial experience gain as required by FASB Staff Position 106-2.

7. Litigation

The Company is involved in various lawsuits and claims arising in the ordinary course of business. The Company follows the provisions of Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (SFAS No. 5). SFAS No. 5 requires that an estimated loss from a loss contingency should be accrued for by a charge to income if it is both probable that an asset has been impaired or that a liability has been incurred and that the amount of the loss can be reasonably estimated.

On June 6, 2001, after receiving paragraph 4 invalidity and noninfringement Hatch-Waxman Act certifications from Apotex indicating that Apotex had filed an Abbreviated New Drug Application with the FDA for a generic form of *Acular*®, the Company and Syntex, the holder of the *Acular*® patent, filed a lawsuit entitled *Syntex (U.S.A.) LLC and Allergan, Inc. v. Apotex, Inc., et al.* in the United States District Court for the Northern District of California. On December 29, 2003, after a trial in June 2003, the court entered Findings of Fact and Conclusions of Law in the Company's favor, thereby holding that the patent at issue is valid, enforceable and infringed by Apotex's proposed generic drug. On January 27, 2004, the court entered final judgment in the Company's favor. On February 17, 2004, Apotex filed a Notice of Appeal with the United States Court of Appeals for the Federal Circuit. The parties have submitted their appeal briefs to the United States Court of Appeals for the Federal Circuit. Oral argument on the appeal is scheduled for November 1, 2004. On June 29, 2001, the Company filed a separate lawsuit in Canada against Apotex similarly relating to a generic version of *Acular*®. A mediation in the Canadian lawsuit has been

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

scheduled for December 20, 2004 and a settlement conference has been scheduled for April 6, 2005.

On January 23, 2003, a complaint entitled *Irena Medavoy and Morris Mike Medavoy v. Arnold W. Klein, M.D., et al. and Allergan, Inc.* was filed in the Superior Court of the State of California for the County of Los Angeles. The complaint contained, among other things, allegations against the Company of negligence, unfair business practices, product liability, intentional misconduct, fraud, negligent misrepresentation, strict liability in tort, improper off-label promotion and loss of consortium. The complaint also contained separate allegations against the other defendants. On April 10, 2003, Morris Mike Medavoy voluntarily served on the Company a Request for Dismissal Without Prejudice for the only two causes of action he asserted in the complaint. The causes of action asserted by Irena Medavoy against the Company were not affected by this Request for Dismissal. On July 8, 2003, Irena Medavoy filed a First Amended Complaint, adding allegations against the Company of false and/or misleading advertising and unjust enrichment, as well as false and/or misleading advertising and unfair competition. A jury trial in the matter began on August 31, 2004. On October 8, 2004, the jury ruled in favor of the Company and Dr. Klein. Also on October 8, 2004, the court dismissed the unfair business practices claims against the Company and Dr. Klein.

On May 17, 2004, a complaint entitled *Utility Consumers Action Network v. Allergan, Inc., et al.* was filed in the Superior Court of the State of California for the County of San Diego. The complaint names the Company and several other defendants. The Company was served with the complaint on July 15, 2004. The complaint alleges unfair business practices and untrue or misleading advertising in violation of the California Business and Professions Code.

On July 13, 2004, the Company received a paragraph 4 invalidity and noninfringement Hatch-Waxman Act certification from Alcon, Inc. indicating that Alcon had filed a New Drug Application (NDA) under section 505(b)(2) of the Federal Food, Drug and Cosmetic Act for a drug containing brimonidine tartrate ophthalmic solution

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

in a 0.15% concentration. In the certification, Alcon contends that U.S. Patent Nos. 5,424,078; 6,562,873; 6,627,210; 6,641,834; and 6,673,337, all of which are assigned to the Company or the Company's wholly-owned subsidiary, Allergan Sales, LLC, and are listed in the Orange Book under *Alphagan*® P, are invalid and/or not infringed by the proposed Alcon product. On August 24, 2004, the Company filed a complaint against Alcon for patent infringement in the United States District Court for the District of Delaware. On September 3, 2004, Alcon filed an answer to the complaint and a counterclaim against the Company. On September 23, 2004, the Company filed a reply to Alcon's counterclaim.

On August 4, 2004, a complaint entitled *The City of New York v. Allergan, Inc., et al.* was filed in the United States District Court for the Southern District of New York. The complaint names the Company and 43 other defendants. The Company was served with the complaint on August 26, 2004. The complaint alleges that the defendants inflated the average wholesale price of pharmaceuticals and reported false pricing information, which increased the cost of the city's Medicaid program. The case is currently stayed pending a ruling on a motion in a related case.

On August 26, 2004, a complaint entitled *Tilley Apothecaries, et al. v. Allergan, Inc., et al.* was filed in the Superior Court of the State of California for the County of Alameda. The complaint names the Company and 12 other defendants. The Company was served with the complaint on August 30, 2004. The complaint alleges unfair business practices based upon a price fixing conspiracy in connection with the reimportation of pharmaceuticals from Canada. On September 3, 2004, the plaintiffs filed a First Amended Complaint, making various modifications to the original complaint. A status conference is scheduled for November 10, 2004.

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

8. Guarantees

The Company's Restated Certificate of Incorporation, as amended, provides that the Company will indemnify, to the fullest extent permitted by the Delaware General Corporation Law, each person that is involved in or is, or is threatened to be, made a party to any action, suit or proceeding by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a director or officer of the Company or was serving at the request of the Company as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise. The Company has also entered into contractual indemnity agreements with each of its directors and executive officers, pursuant to which the Company has agreed to indemnify such directors and executive officers against any payments they are required to make as a result of a claim brought against such executive officer or director in such capacity, excluding claims (i) relating to the action or inaction of a director or executive officer that resulted in such director or executive officer gaining personal profit or advantage, (ii) for an accounting of profits made from the purchase or sale of securities of the Company within the meaning of Section 16(b) of the Securities Exchange Act of 1934 or similar provisions of any state law or (iii) that are based upon or arise out of such director's or executive officer's knowingly fraudulent, deliberately dishonest or willful misconduct. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is unlimited. However, the Company has purchased directors' and officers' liability insurance policies intended to reduce the Company's monetary exposure and to enable the Company to recover a portion of any future amounts paid. The Company has not previously paid any material amounts to defend lawsuits or settle claims as a result of these indemnification provisions. As a result, the Company believes the estimated fair value of these indemnification arrangements is minimal.

The Company customarily agrees in the ordinary course of its business to indemnification provisions in agreements with clinical trials investigators in its drug development programs, in sponsored research agreements with academic and not-for-profit institutions, in various comparable agreements involving parties performing services for the Company in the ordinary course of business, and in its real estate leases. The Company also customarily agrees to certain indemnification provisions in its drug discovery and development collaboration agreements. With respect to the Company's clinical trials and sponsored research agreements, these indemnification provisions typically apply to any claim asserted against the investigator or the investigator's institution relating to personal injury or property damage, violations of law or certain breaches of the Company's contractual obligations arising out of the research or clinical testing of the Company's compounds or drug candidates. With respect to real estate lease agreements, the indemnification provisions typically apply to claims asserted against the landlord relating to personal injury or property damage caused by the Company, to violations of law by the Company or to certain breaches of the Company's contractual obligations. The indemnification provisions appearing in the Company's collaboration

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

agreements are similar, but in addition provide some limited indemnification for the collaborator in the event of third party claims alleging infringement of intellectual property rights. In each of the above cases, the term of these indemnification provisions generally survives the termination of the agreement. The maximum potential amount of future payments that the Company could be required to make under these provisions is generally unlimited. The Company has purchased insurance policies covering personal injury, property damage and general liability intended to reduce the Company's exposure for indemnification and to enable the Company to recover a portion of any future amounts paid. The Company has not previously paid any material amounts to defend lawsuits or settle claims as a result of these indemnification provisions. As a result, the Company believes the estimated fair value of these indemnification arrangements is minimal.

9. Earnings Per Share

The table below presents the computation of basic and diluted earnings per share:

(in millions, except per share amounts)	Three months ended		Nine months ended	
	Sept. 24, 2004	Sept. 26, 2003	Sept. 24, 2004	Sept. 26, 2003
Basic net earnings	\$ 92.0	\$ 76.0	\$264.6	\$ 38.3
Interest expense from convertible subordinated notes, net of tax	—	0.2	—	—
Diluted net earnings	\$ 92.0	\$ 76.2	\$264.6	\$ 38.3
Weighted average number of shares issued	131.5	130.5	131.3	130.2
Net shares assumed issued using the treasury stock method for options outstanding during each period based on average market price	0.7	2.1	1.7	1.9
Dilutive effect of assumed conversion of convertible subordinated notes outstanding	—	0.4	—	—
Diluted shares	132.2	133.0	133.0	132.1
Earnings per share:				
Basic	\$ 0.70	\$ 0.58	\$ 2.02	\$ 0.29
Diluted	\$ 0.70	\$ 0.57	\$ 1.99	\$ 0.29



For the three and nine month periods ended September 24, 2004, options to purchase 5.5 million and 2.2 million shares of common stock at exercise prices ranging from \$76.51 to \$127.51, and \$83.79 to \$127.51, respectively, were outstanding, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than



Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

the average market price of common shares and, therefore, the effect would be anti-dilutive. For the three and nine month periods ended September 26, 2003, options to purchase 3.7 million and 3.8 million shares of common stock, respectively, at exercise prices ranging from \$80.00 to \$127.51, and \$73.17 to \$127.51, respectively, were outstanding, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of common shares and, therefore, the effect would be anti-dilutive.

The effect of approximately 1.6 million and 1.7 million shares of common stock for the three and nine month periods ended September 24, 2004, respectively, and 1.7 million shares of common stock for the three and nine month periods ended September 26, 2003 related to the assumed conversion of the \$641.5 million aggregate principal amount convertible senior notes due 2022 (Senior Notes), has been excluded from the calculation of diluted earnings per share because none of the conditions that would permit conversion of the Senior Notes were satisfied during those periods. On July 28, 2004, the Company, together with Wells Fargo Bank, as trustee, executed a supplemental indenture to the indenture governing the Senior Notes. The supplemental indenture amends the indenture's redemption and conversion provisions to restrict the Company's ability to issue common stock in lieu of cash to holders of the Senior Notes upon any redemption or conversion. Upon any redemption, the Company is now required to pay the entire redemption amount in cash. In addition, upon any conversion, the Company will pay cash up to the accreted value of the Senior Notes converted and will have the option to pay any amounts due in excess of the accreted value in either cash or common stock. The rights of the holders of the Senior Notes were not affected or limited by the supplemental indenture. The dilutive effects indicated above were calculated using the amended terms of the Senior Notes whereby the accreted value is settled in cash and assumes the closing price of the Company's common stock achieved the minimum price allowed for conversion during the periods.

For the nine month period ended September 26, 2003, the effect of approximately 0.4 million shares of common stock related to the zero coupon convertible subordinated notes due 2020 was not included in the computation of diluted earnings per share because the effect would be anti-dilutive.

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

10. Comprehensive Income

The following tables summarize components of comprehensive income for the three and nine month periods ended September 24, 2004, and September 26, 2003:

(in millions)	Three months ended					
	September 24, 2004			September 26, 2003		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
Foreign currency translation adjustments	\$3.8	\$	\$ 3.8	\$(0.8)	\$	\$ (0.8)
Unrealized holding gains/(losses) arising during period	<u>0.2</u>	-	<u>0.2</u>	<u>0.5</u>	<u>(0.1)</u>	<u>0.4</u>
Other comprehensive earnings (loss)	<u>\$4.0</u>	\$	4.0	<u>\$(0.3)</u>	<u>\$(0.1)</u>	(0.4)
Net earnings			<u>92.0</u>			<u>76.0</u>
Total comprehensive income			<u>\$96.0</u>			<u>\$75.6</u>

(in millions)	Nine months ended					
	September 24, 2004			September 26, 2003		
	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
Foreign currency translation adjustments	\$(0.7)	\$	\$ (0.7)	\$ 9.1	\$	\$ 9.1

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Unrealized holding gains/(losses) arising during period	<u>(0.1)</u>	<u>0.1</u>	<u> </u>	<u>3.2</u>	<u>(1.1)</u>	<u>2.1</u>
Other comprehensive earnings (loss)	<u>\$(0.8)</u>	<u>\$0.1</u>	<u>(0.7)</u>	<u>\$12.3</u>	<u>\$(1.1)</u>	<u>11.2</u>
Net earnings			<u>264.6</u>			<u>38.3</u>
Total comprehensive income			<u>\$263.9</u>			<u>\$49.5</u>

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

11. Business Segment Information

The Company operates its business on the basis of a single reportable segment specialty pharmaceuticals. The Company 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*® for certain therapeutic and cosmetic indications. The Company provides global marketing strategy teams to ensure development and execution of a consistent marketing strategy for its products in all geographic regions that share similar distribution channels and customers.

Management evaluates its various global product portfolios on a revenue basis, which is presented below. The Company's principal markets are the United States, Europe, Latin America and Asia Pacific. The United States information is presented separately as it is the Company's headquarters country, and U.S. sales, including manufacturing operations, represented 69.2% and 69.3% of the Company's total consolidated product net sales for the quarters ended September 24, 2004 and September 26, 2003, respectively, and 69.4% and 70.7% of the Company's total consolidated product net sales for the nine month periods ended September 24, 2004 and September 26, 2003, respectively.

Sales to McKesson Drug Company for the three month periods ended September 24, 2004 and September 26, 2003 were 13.9% and 12.7%, respectively, of the Company's total consolidated product net sales and 13.7% and 14.0% of the Company's total consolidated product net sales for the nine month periods ended September 24, 2004 and September 26, 2003, respectively. Sales to Cardinal Healthcare for the three month periods ended September 24, 2004 and September 26, 2003 were 13.9% and 14.3%, respectively, of the Company's total consolidated product net sales and 13.6% and 14.0% of the Company's total consolidated product net sales for the nine month periods ended September 24, 2004 and September 26, 2003, respectively. No other country or single customer generates over 10% of total product net sales. Other product net sales and net sales for manufacturing operations primarily represent sales to Advanced Medical Optics, Inc. (AMO) pursuant to the manufacturing and supply agreement entered into as part of the 2002 spin-off of AMO. Net sales for the Europe region also include sales to customers in Africa and the Middle East, and net sales in the Asia Pacific region include sales to customers in Australia and New Zealand.

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Long-lived assets are assigned to geographic regions based upon management responsibility for such items.

Net Sales by Product Line
(in millions)

	Three months ended		Nine months ended	
	September 24, 2004	September 26, 2003	September 24, 2004	September 26, 2003
Specialty Pharmaceuticals:				
Eye Care Pharmaceuticals	\$ 285.4	\$ 252.8	\$ 835.1	\$ 727.1
<i>Botox</i> ®/Neuromodulators	174.6	139.9	502.2	406.1
Skin Care	24.8	29.2	73.9	79.8
	<hr/>	<hr/>	<hr/>	<hr/>
	484.8	421.9	1,411.2	1,213.0
Other	26.0	21.4	78.2	63.0
	<hr/>	<hr/>	<hr/>	<hr/>
Net sales	\$ 510.8	\$ 443.3	\$ 1,489.4	\$ 1,276.0
	<hr/>	<hr/>	<hr/>	<hr/>

Geographic Information

Net Sales
(in millions)

	Three months ended		Nine months ended	
	September 24, 2004	September 26, 2003	September 24, 2004	September 26, 2003
United States	\$ 328.8	\$ 287.2	\$ 960.6	\$ 843.8
Europe	82.9	69.7	240.6	196.5
Latin America	25.5	25.0	72.7	62.9
Asia Pacific	31.7	27.2	90.9	71.5
Other	17.4	14.1	51.1	42.5
	<hr/>	<hr/>	<hr/>	<hr/>
	486.3	423.2	1,415.9	1,217.2
Manufacturing operations	24.5	20.1	73.5	58.8
	<hr/>	<hr/>	<hr/>	<hr/>

Net sales	\$ 510.8	\$ 443.3	\$1,489.4	\$1,276.0
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Long-Lived Assets
(in millions)

	September 24, 2004	December 31, 2003
United States	\$ 160.7	\$ 168.5
Europe	35.3	34.8
Latin America	20.5	32.8
Asia Pacific	4.7	5.5
Other	0.9	0.9
	<hr/>	<hr/>
Manufacturing operations	222.1	242.5
General corporate	250.4	240.4
	389.5	343.8
	<hr/>	<hr/>
Total	\$ 862.0	\$ 826.7
	<hr/>	<hr/>

12. Sales Tax Contingency

In accordance with the Company's interpretation of current law, the Company generally does not collect sales tax on sales of *Botox*® or *Botox*® Cosmetic in the United States. However, the Company believes that one or more states may seek to impose sales tax collection obligations on the Company's sales of *Botox*® or *Botox*® Cosmetic to physicians and other

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

customers. If it is determined that the Company should collect sales tax in one or more states, the imposition and collection of sales tax on *Botox*® or *Botox*® Cosmetic could result in a substantial tax liability, and potential penalties and interest, for prior taxable periods. The imposition of sales tax on *Botox*® or *Botox*® Cosmetic could also adversely affect our sales or our product margins on *Botox*® or *Botox*® Cosmetic due to the increased cost associated with those products.

The Company is not currently aware of any asserted claims for sales tax liabilities for prior taxable periods. The Company intends to work with state taxing authorities in the normal course of business to ensure the proper interpretation and administration of sales tax regulations on sales of *Botox*® and *Botox*® Cosmetic. The Company has not recorded any accrued costs for potential unasserted claims for unpaid sales tax. The Company does not currently believe that any individual claim or aggregate claims that might arise will ultimately have a material effect on its consolidated results of operations, financial position or cash flows.

13. Subsequent Events

Effective October 27, 2004, the Company's board of directors approved certain restructuring activities related to the scheduled termination of the Company's manufacturing and supply agreement with Advanced Medical Optics, Inc.(AMO). Under the manufacturing and supply agreement, which was entered into in connection with the June 2002 spin-off of AMO, the Company agreed to manufacture certain contact lens care products and VITRAX for AMO for a period of up to three years ending on June 30, 2005. As part of the termination of the manufacturing and supply agreement, the Company will eliminate certain manufacturing positions at its Westport, Ireland; Waco, Texas; and Guarulhos, Brazil manufacturing facilities.

The Company anticipates that the additional pre-tax restructuring charges to be incurred in connection with the termination of the manufacturing and supply agreement, which are expected to total between \$24 million and \$28 million, will be recorded beginning in the fourth quarter of 2004 and continue up through and including the fourth quarter of 2005. The pre-tax charges are net of expected tax credits available under qualifying government-sponsored employment programs. Approximately \$24 million of the additional restructuring charges are expected to be cash charges. The additional restructuring charges are expected to include approximately \$20 million to \$22 million associated with the reduction in the Company's workforce by approximately 450 individuals. The workforce reduction will impact personnel in Europe, the United States and Latin America. The workforce reduction will begin in the fourth quarter of 2004 and is expected to be completed by the end of the second quarter 2005. The additional restructuring costs are also expected to include approximately \$4 million to \$6 million associated with asset write-offs and other costs associated with the termination of the manufacturing and supply agreement. Certain restructuring charges related to asset disposal will be recorded through the fourth quarter of 2005.

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

On September 27, 2004, the Company entered into an agreement with Ista Pharmaceuticals, Inc. (Ista) to replace their previous *Vitrase*® product collaboration. As part of the new agreement, Ista reacquired all rights to market and sell *Vitrase*® for all uses in the United States and many other markets worldwide. The Company retained an option to commercialize *Vitrase*® for the posterior segment of the eye in Europe. Under the new agreement, Ista will pay the Company \$10.0 million, of which \$6.5 million was paid in October 2004, with the remainder payable subject to Ista's completion of qualified financing. Ista will also make certain royalty payments to the Company on Ista's U.S. sales of *Vitrase*® for use in the posterior segment of the eye.

ALLERGAN, INC.

Item 2. 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 QUARTER ENDED SEPTEMBER 24, 2004

This financial review presents our operating results for the three and nine month periods ended September 24, 2004 and September 26, 2003, and our financial condition at September 24, 2004. Except for the historical information contained herein, the following discussion contains forward-looking statements which are subject to known and unknown risks, uncertainties and other factors that may cause our actual results to differ materially from those expressed or implied by such forward-looking statements. We discuss such risks, uncertainties and other factors throughout this report and specifically under the caption "Certain Factors and Trends Affecting Allergan and its Businesses" below. In addition, the following review should be read in connection with the information presented in our unaudited condensed consolidated financial statements and related notes for the three and nine month periods ended September 24, 2004.

CRITICAL ACCOUNTING POLICIES

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

Revenue Recognition

We recognize revenue from product sales when goods are shipped and title and risk of loss transfer to the customer. We generally offer cash discounts to customers for the early payment of receivables. Those discounts are recorded as a reduction of accounts receivable in the same period the related sale is recorded. The amounts reserved for cash discounts at September 24, 2004 and December 31, 2003 were \$1.5 million and \$1.2 million, respectively. We permit returns of product from any product line by any class of customer if such product is returned in a timely manner, in good condition and from the normal channels of distribution. Return policies in certain international markets provide for more stringent guidelines in accordance with the terms of contractual agreements with customers. Allowances for returns are provided for based upon our historical patterns of returns matched against the sales from which they originated. The amount of allowances for sales returns reserved at September 24, 2004 and December 31, 2003 were \$5.4 million and \$6.3 million, respectively. Additionally, we participate in various managed care sales rebate and other incentive programs, the largest of which relates to Medicaid. Sales rebate and incentive accruals reduce revenue in the same period the related sale is recorded and are included in "Accrued expenses" in our unaudited condensed consolidated balance sheets. The accruals for sales rebates and other incentive programs are based on estimates of the proportion of sales that are subject to such rebates and incentive programs. The amounts accrued for sales rebates and other

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

CRITICAL ACCOUNTING POLICIES (Continued)

incentive programs at September 24, 2004 and December 31, 2003 were \$60.0 million and \$49.5 million, respectively. The increase in the amount accrued for sales rebates and other incentive programs is primarily due to a difference in the timing of when payments were made against accrued amounts at September 24, 2004 compared to December 31, 2003 and an increase in the ratio of U.S. pharmaceutical product sales, principally eye care pharmaceutical products, subject to such rebates and incentive programs.

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

Pensions

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

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

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

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

CRITICAL ACCOUNTING POLICIES (Continued)

projected benefit obligations at December 31, 2003 by approximately \$11 million.

Income Taxes

Income taxes are determined using an estimated annual effective tax rate, which is generally less than the U.S. Federal statutory rate, primarily because of lower tax rates in certain non-U.S. jurisdictions and research and development, or R&D, tax credits available in the United States. Our effective tax rate may be subject to fluctuations during the fiscal year as new information is obtained, which may affect the assumptions we use to estimate our annual effective tax rate, including factors such as our mix of pre-tax earnings in the various tax jurisdictions in which we operate, valuation allowances against deferred tax assets, reserves for tax contingencies, utilization of R&D tax credits and changes in or interpretation of tax laws in jurisdictions where we conduct operations. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities, along with net operating loss and credit carryforwards. We record a valuation allowance against our deferred tax assets to reduce the net carrying value to an amount that we believe is more likely than not to be realized. When we establish or reduce the valuation allowance against our deferred tax assets, our income tax expense will increase or decrease, respectively, in the period such determination is made.

Valuation allowances against our deferred tax assets were \$52.7 million at September 24, 2004 and \$62.6 million at December 31, 2003. The decrease in the amount of valuation allowances at September 24, 2004 compared to December 31, 2003 is primarily due to a change in the estimated amount of R&D tax credits that we believe will be realized during the current year. The reduction in the valuation allowances recorded in the first nine months of 2004 is a component of the estimated annual effective tax rate. This change in estimate occurred due to improved clarity regarding the calculation of these credits provided by the completion of recent statutory audits and our improved domestic profitability, which we expect will allow a greater amount of R&D tax credits to be realized than previously estimated. Material differences in the estimated amount of valuation allowances may result in an increase or decrease in the provision for income taxes if the actual amounts for valuation allowances required against deferred tax assets differ from the amounts estimated by us.

We have not provided for withholding and U.S. taxes for the unremitted earnings of certain non-U.S. subsidiaries because we have reinvested or expect to reinvest these earnings permanently in such operations. At December 31, 2003, we had approximately \$712 million in unremitted earnings outside the United States for which withholding and U.S. taxes were not provided. Tax expense would be incurred if these funds were remitted to the United States. It is not practicable to estimate the amount of the deferred

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

CRITICAL ACCOUNTING POLICIES (Continued)

tax liability on such unremitted earnings. Upon remittance, certain foreign countries impose withholding taxes that are then available, subject to certain limitations, for use as credits against our U.S. tax liability. We annually update our estimate of unremitted earnings outside the United States after the completion of each fiscal year.

On October 22, 2004, the American Jobs Creation Act of 2004 was enacted in the United States. We are currently evaluating the impact of this new law on our operations and effective tax rate. In particular, we are evaluating the law's provisions relating to incentives to reinvest foreign earnings in the United States, which require a domestic reinvestment plan to be created and approved by our board of directors before executing any repatriation activities. We currently have no plans to change our policy regarding permanent reinvestment of unremitted earnings in our foreign operations. We are also evaluating allowable deductions, beginning in 2005, for income attributable to United States production activities. At this time, we are unable to determine the effects of this new law and will continue to analyze its potential impact as guidance is made available.

Purchase Price Allocation

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

During 2003, we acquired Oculex Pharmaceuticals, Inc., or Oculex, and Bardeen Sciences Company, LLC, or Bardeen, for aggregate purchase prices of approximately \$223.8 million and \$264.6 million, respectively. The prices were allocated to identified assets acquired and liabilities assumed based on their estimated fair values as of the acquisition dates. The Oculex transaction was determined to be a business combination, while the Bardeen transaction was considered to be an asset acquisition and not a business combination.

We determined that the assets acquired from Oculex and Bardeen consisted principally of incomplete in-process research and development and that these projects had no alternative future uses in their current state. We reached this conclusion based on discussions with our business development and research and development personnel, our review of long-range product plans and our review of a valuation report prepared by an independent valuation specialist. The valuation specialist's report reached a conclusion with regard to the fair value of the in-process research and development assets in a manner consistent with principles prescribed in the AICPA practice aid, *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic*

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

CRITICAL ACCOUNTING POLICIES (Continued)

Devices and Pharmaceutical Industries. In connection with the acquisition of Oculex, we determined that the assets acquired also included a proprietary technology drug delivery platform that was separately valued and capitalized as core technology. We reached this conclusion based on our determination that the acquired technology had alternative future uses in its current state. We believe the fair values assigned to the assets acquired and liabilities assumed are based on reasonable assumptions.

OPERATIONS

Headquartered in Irvine, California, we are a technology-driven, global health care company that develops and commercializes specialty pharmaceutical products for the ophthalmic, neurological, dermatological and other specialty markets. We employ approximately 5,060 persons around the world. We are an innovative leader in therapeutic and over-the-counter products that are sold in more than 100 countries. Our principal markets are the United States, Europe, Latin America and Asia Pacific.

RESULTS OF OPERATIONS

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

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

The following tables compare 2004 and 2003 net sales by product line and certain selected products for the three and nine month periods ended September 24, 2004 and September 26, 2003:

(in millions)	<u>Three months ended</u>		<u>Change in Net Sales</u>			<u>Percent Change in Net Sales</u>		
	<u>Sept. 24, 2004</u>	<u>Sept. 26, 2003</u>	<u>Total</u>	<u>Performance</u>	<u>Currency</u>	<u>Total</u>	<u>Performance</u>	<u>Currency</u>
Net Sales by Product Line:								
Eye Care								
Pharmaceuticals	\$ 285.4	\$ 252.8	\$ 32.6	\$ 27.5	\$ 5.1	12.9%	10.9%	2.0%
<i>Botox</i> /Neuromodulator	174.6	139.9	34.7	31.8	2.9	24.8%	22.7%	2.1%
Skin Care	24.8	29.2	(4.4)	(4.4)		(15.1)%	(15.1)%	%
Total	484.8	421.9	62.9	54.9	8.0	14.9%	13.0%	1.9%
Other*	26.0	21.4	4.6	4.6		21.5%	21.5%	%
Total net sales	\$ 510.8	\$ 443.3	\$ 67.5	\$ 59.5	\$ 8.0	15.2%	13.4%	1.8%
Domestic	69.2%	69.3%						
International	30.8%	30.7%						
<i>Selected Product Sales:</i>								
Alphagan P and								
Alphagan	\$ 73.0	\$ 71.4	\$ 1.6	\$ 0.4	\$ 1.2	2.2%	0.6%	1.6%
Lumigan	60.3	46.8	13.5	12.3	1.2	28.8%	26.3%	2.5%
Other Glaucoma	4.6	5.5	(0.9)	(1.1)	0.2	(16.4)%	(20.0)%	3.6%
Restasis	24.1	10.7	13.4	13.5	(0.1)	125.2%	126.2%	(1.0)%
Tazorac, Zorac and Avage	18.8	22.3	(3.5)	(3.6)	0.1	(15.7)%	(16.1)%	0.4%

(in millions)	<u>Nine months ended</u>		<u>Change in Net Sales</u>			<u>Percent Change in Net Sales</u>		
	<u>Sept. 24, 2004</u>	<u>Sept. 26, 2003</u>	<u>Total</u>	<u>Performance</u>	<u>Currency</u>	<u>Total</u>	<u>Performance</u>	<u>Currency</u>

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Net Sales by Product

Line:

Eye Care

Pharmaceuticals	\$ 835.1	\$ 727.1	\$108.0	\$ 87.7	\$20.3	14.9%	12.1%	2.8%
<i>Botox</i> /Neuromodulator	502.2	406.1	96.1	85.1	11.0	23.7%	21.0%	2.7%
Skin Care	73.9	79.8	(5.9)	(6.0)	0.1	(7.4)%	(7.5)%	0.1%

Total	1,411.2	1,213.0	198.2	166.8	31.4	16.3%	13.8%	2.5%
Other*	78.2	63.0	15.2	15.0	0.2	24.1%	23.8%	0.3%

Total net sales	\$1,489.4	\$1,276.0	\$213.4	\$ 181.8	\$31.6	16.7%	14.2%	2.5%
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Domestic	69.4%	70.7%
International	30.6%	29.3%

Selected Product Sales:

Alphagan P and

Alphagan	\$ 204.7	\$ 213.6	\$ (8.9)	\$ (13.3)	\$ 4.4	(4.2)%	(6.2)%	2.0%
Lumigan	171.1	129.6	41.5	37.1	4.4	32.0%	28.6%	3.4%
Other Glaucoma	14.8	16.7	(1.9)	(2.8)	0.9	(11.4)%	(16.8)%	5.4%
Restasis	65.5	22.5	43.0	43.0		191.1%	191.1%	
Tazorac, Zorac and Avage	53.9	58.9	(5.0)	(5.0)		(8.5)%	(8.5)%	

* Other sales primarily consist of sales to Advanced Medical Optics, Inc. pursuant to a manufacturing and supply agreement entered into as part of the spin-off of Advanced Medical Optics, Inc. in June 2002.

The \$8.0 million increase in net sales from the impact of foreign currency changes for the three month period ended September 24, 2004 was due

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

primarily to the strengthening of the euro, Japanese yen, Australian dollar, British pound and Canadian dollar compared to the U.S. dollar. The \$31.6 million increase in net sales from the impact of foreign currency changes for the first nine months of 2004 was due primarily to the strengthening of the euro, Japanese yen, Australian dollar, British pound, Canadian dollar and Brazilian real compared to the U.S. dollar.

The \$67.5 million increase in net sales in the third quarter of 2004 compared to the third quarter of 2003 was primarily the result of increases in sales of our *Botox*® and eye care pharmaceuticals product lines and an increase in other non-pharmaceutical sales, partially offset by a decrease in sales of skin care products. Eye care pharmaceuticals sales increased in the third quarter of 2004 compared to the third quarter of 2003 primarily because of strong growth in sales of our glaucoma drug *Lumigan*®, growth in sales of *Restasis*®, our drug for the treatment of therapeutic dry eye disease, growth in sales of eye drop products, primarily *Refresh*®, an increase in sales of *Zymar*®, a newer generation anti-infective, new product sales generated from *Elestat* , our topical antihistamine used for the prevention of itching associated with allergic conjunctivitis that was launched in the United States in the first quarter of 2004 by our co-promotion partner, Inspire Pharmaceuticals, Inc., and an increase in sales of *Acular LS* , our newer generation non-steroidal anti-inflammatory. This increase in sales was partially offset by a decrease in sales of *Ocuflox*®, our older generation anti-infective that is experiencing generic competition in the U.S., and *Acular*®, our older generation anti-inflammatory. We estimate the majority of the change in our eye care pharmaceutical sales was due to mix and volume changes; however, we increased the published list prices for certain eye care pharmaceutical products in the United States, ranging from zero to nine percent, effective January 10, 2004. We increased the published U.S. list price for *Lumigan*® by five percent, and we left the price of *Restasis*® unchanged as of the same effective date. On May 29, 2004, we increased the published U.S. list price for *Restasis*® by five percent. This increase in prices had a subsequent positive net effect on our U.S. sales, but the actual net effect is difficult to determine due to the various managed care sales rebate and other incentive programs in which we participate. The change in dollar value of prescription product mix also affected our reported net sales dollars. We have a policy to attempt to maintain average U.S. wholesaler inventory levels of our products at an amount between one and two months of our net sales.

Botox® sales increased in the third quarter of 2004 compared to the third quarter of 2003 primarily as a result of strong growth in demand in the United States and international markets for both therapeutic and cosmetic uses. During the second quarter of 2004, we launched *Vistabel*® in Spain and certain Scandinavian countries and *Vistabex* in Italy. *Vistabel*® and *Vistabex* are the trade names for *Botox*® Cosmetic in Europe and Italy, respectively. Effective December 22, 2003, we increased the published price for *Botox*® and *Botox*® Cosmetic in the United States by approximately

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

seven percent, which we believe had a corresponding positive effect on our U.S. sales growth in 2004. We believe our worldwide market share for neuromodulators, including *Botox*®, is over 85%.

Skin care sales decreased in the third quarter of 2004 compared to the third quarter of 2003 primarily due to lower sales of *Tazorac*® in the United States, where it is FDA approved to treat both psoriasis and acne. We increased the published U.S. list price for *Tazorac*® by nine percent effective January 10, 2004 and by an additional five percent effective July 31, 2004.

The \$213.4 million increase in net sales in the first nine months of 2004 compared to the same 2003 period was primarily the result of an increase in sales of our eye care pharmaceuticals and *Botox*® product lines and an increase in other non-pharmaceutical sales, partially offset by a decline in sales of skin care products. Eye care pharmaceuticals and *Botox*® sales increased primarily for the same reasons discussed in the analysis of the third quarter 2004 increase in net sales. For the first nine months of 2004, our *Alphagan*® franchise sales also decreased due to a general decline in U.S. wholesaler demand for *Alphagan*® P, market share erosion from generic *Alphagan*® competition and an increase in the ratio of *Alphagan*® P sales subject to Medicaid rebates in the United States. We continue to believe that generic formulations of *Alphagan*® will have a negative impact on future net sales of our *Alphagan*® franchise. *Botox*® sales also benefited from strong sales growth in Europe, especially in France, Spain and Italy, as a result of the March 2003 launch in France of *Vistabel*® and the second quarter 2004 launches of *Vistabel*® and *Vistabex*® in certain European countries, as well as an increase in sales of *Botox*® in smaller distributor markets serviced by our European export sales group. Skin care sales declined in the first nine months of 2004 compared to the first nine months of 2003 primarily due to lower sales of *Avage*®, which we launched in the U.S. in the first quarter of 2003, and a decrease in sales of *Tazorac*® in the United States.

The decrease in the percentage of U.S. sales as a percentage of total product net sales during the first nine months of 2004 compared to the same period in 2003 was primarily attributable to an increase in international eye care pharmaceuticals and *Botox*® sales, principally in Europe and Asia Pacific, as a percentage of total product net sales.

Our gross margin percentage for the third quarter of 2004 was 80.6% of net sales, which represents a 0.7 percentage point decrease from our gross margin percentage of 81.3% for the third quarter of 2003. The gross margin percentage for the nine months ended September 24, 2004 was 81.0% of net sales, which represents a 0.9 percentage point decrease from the 81.9% rate reported for the first nine months of 2003. Our gross margin percentage decreased in the third quarter of 2004 compared to the third quarter of

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

2003 primarily as a result of a decrease in gross margin percentage for eye care pharmaceuticals, the *Botox*® product line and skin care products, partially offset by an increase in gross margin percentage for contract manufacturing sales to Advanced Medical Optics, Inc. and an increase in the mix of *Botox*® sales. Net sales of *Botox*®, which generally have a higher gross margin percentage than our other pharmaceutical product lines, represented a greater percentage of third quarter 2004 sales compared to the third quarter of 2003. The gross margin percentage for eye care pharmaceuticals declined in the third quarter of 2004 compared to the third quarter of 2003 due to a higher ratio of U.S. sales subject to Medicaid rebates and other incentive programs and products with higher royalty rates payable to third parties, partially offset by a decrease in the mix of international sales, which generally have a lower gross margin percentage than U.S. sales. The gross margin percentage for our *Botox*® product line experienced a decline in the third quarter of 2004 compared to the same period in 2003 due primarily to an increase in the mix of international sales, which generally have a lower gross margin percentage than U.S. sales. The gross margin percentage for contract manufacturing sales improved primarily due to an increase in U.S. dollar denominated pricing allowed under the manufacturing and supply agreement with Advanced Medical Optics, Inc. at the beginning of our 2004 fiscal year. Gross margin in dollars increased in the third quarter of 2004 compared to the third quarter of 2003 by \$51.2 million, or 14.2%, as a result of the 15.2% increase in net sales, partially offset by the 0.7 percentage point decrease in gross margin percentage.

Our gross margin percentage decreased in the first nine months of 2004 compared to the nine months ended September 26, 2003, primarily for the same reasons discussed in the analysis of the third quarter 2004 decrease in gross margin percentage, except that the gross margin percentage for eye care pharmaceuticals sales in the first nine months of 2004 compared to the first nine months of 2003 was also negatively impacted by an increase in the percentage of net sales derived from international sales, which generally have a lower gross margin percentage than U.S. sales. During the first nine months of 2004, the decrease in our gross margin percentage was also partially offset by certain annual contract manufacturing cost recoveries allowed under the manufacturing and supply agreement with Advanced Medical Optics, Inc.

We have historically recognized research service revenues and costs associated with various contract research and developmental arrangements. Research service revenues and costs have declined in 2004 compared to 2003 as a result of our acquisition of Bardeen Sciences Company, LLC, or Bardeen, in 2003. Prior to the Bardeen acquisition, we performed research and development services on compounds owned by Bardeen pursuant to a research and development services agreement between us and Bardeen. Since May 16, 2003, we have not been a party to any contract research and development arrangements similar to those previously reported.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

Selling, general and administrative, or SG&A, expenses were \$195.5 million, or 38.3% of net sales, in the third quarter of 2004 compared to \$171.1 million, or 38.6% of net sales, in the third quarter of 2003. SG&A expenses for the first nine months of 2004 were \$572.8 million, or 38.5% of net sales, compared to \$526.2 million, or 41.2% of net sales, in the comparable 2003 period. The increase in SG&A expense dollars in the third quarter of 2004 compared to the third quarter of 2003 was primarily a result of higher selling expenses, principally personnel costs, and promotion expenses supporting the increase in consolidated sales, especially for *Lumigan*®, *Restasis*®, *Zymar*® and *Botox*® sales in the United States and *Lumigan*®, *Botox*®, *Vistabel*® and *Vistabex* sales in Europe, an increase in promotion costs associated with direct to consumer advertising in the U.S. for *Restasis*®, an increase in co-promotion costs related to sales of *Elestat*®, higher general and administrative expenses, primarily Sarbanes-Oxley compliance, corporate insurance, facilities and other finance function related costs, an increase in the loss on disposal of fixed assets, and lower miscellaneous royalty income. These increases were partially offset by a decrease in costs of providing product samples and information services expenses.

The increase in SG&A expense dollars in the first nine months of 2004 compared to the first nine months of 2003 was primarily a result of higher selling and marketing expenses, principally personnel costs, supporting the increase in consolidated sales, especially for *Botox*®, *Restasis*®, *Lumigan*® and *Zymar*® in the United States and *Botox*®, *Vistabel*®, *Vistabex* and *Lumigan*® sales in Europe, an increase in co-promotion costs related to sales of *Elestat*®, higher general and administrative expenses, primarily corporate insurance, Sarbanes-Oxley compliance, information services, facilities and legal costs, and an increase in the loss on disposal of fixed assets. These increases were partially offset by a decrease in promotion expenses due to the non-recurrence of costs associated with the product launches in 2003 of *Restasis*®, *Zymar*® and *Avage*® and a favorable \$2.4 million settlement during the first quarter of 2004 relating to a patent dispute covering the use of botulinum toxin type B for cervical dystonia.

SG&A expenses in the third quarter and first nine months of 2004 were also negatively impacted by an increase in the translated U.S. dollar value of foreign currency denominated expenses, especially in Europe, compared to the same periods in 2003. As a percentage of net sales, SG&A expenses declined in the third quarter of 2004 compared to the third quarter of 2003, due primarily to lower promotion, marketing and general and administrative expenses as a percentage of net sales. As a percentage of net sales, SG&A expenses declined in the first nine months of 2004 compared to the same period in 2003, due primarily to lower promotion, selling and marketing expenses, as a percentage of net sales.

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

Research and development expenses were \$83.0 million, or 16.2% of net sales, in the third quarter of 2004 compared to \$81.0 million, or 18.3% of net sales, in the third quarter of 2003. For the nine months ended September 24, 2004, research and development expenses were \$257.6 million compared to \$492.6 million for the first nine months of 2003. Research and development expenses for the nine months ended September 26, 2003 included a charge of \$278.8 million related to acquired in-process research and development assets associated with the May 2003 purchase of Bardeen Sciences Company, LLC, which we determined were not yet complete and had no alternative uses in their current state. Excluding the effect of the \$278.8 million charge in 2003, research and development expenses increased by \$43.8 million to \$257.6 million, or 17.3% of net sales, in the first nine months of 2004 compared to \$213.8 million, or 16.8% of net sales, in the nine months ended September 26, 2003. Research and development spending increased in the third quarter of 2004 compared to the third quarter in 2003 primarily as a result of higher rates of investment in our *Botox*® product line and new technologies, partially offset by a decline in spending for skin care products. Research and development spending increased in the first nine months of 2004 compared to the same 2003 period, primarily as a result of higher rates of investment in our eye care and *Botox*® product lines and new technologies, partially offset by a small decline in spending for our skin care product line. Research and development spending in first nine months of 2004 compared to the same period in 2003 increased most significantly in eye care pharmaceuticals due to increased spending for technologies not currently commercialized by us which were acquired in 2003 from the acquisitions of Bardeen Sciences Company, LLC and Oculex Pharmaceuticals, Inc.

Operating income in the third quarter of 2004 was \$133.2 million compared to operating income of \$108.4 million for the third quarter of 2003. The \$24.8 million increase in operating income was due primarily to the \$51.2 million increase in gross margin, partially offset by the increase in SG&A expenses of \$24.4 million and research and development expenses of \$2.0 million. Our operating income in the first nine months of 2004 was \$376.1 million compared to operating income of \$27.4 million for the first nine months of 2003. The \$348.7 million increase in operating income was due primarily to the \$161.8 million increase in gross margin and the \$235.0 million decrease in research and development expenses, partially offset by the increase in SG&A expenses of \$46.6 million.

Total net non-operating expenses in the third quarter of 2004 were \$0.7 million compared to expenses of \$2.0 million in the third quarter of 2003. Interest income in the third quarter of 2004 was \$2.6 million, unchanged from interest income of \$2.6 million in the third quarter of 2003. During the third quarter of 2004, higher average cash equivalent balances earning interest of approximately \$23 million were offset by a decline in average interest rates earned on all cash equivalent balances earning interest of approximately 0.20% in the third quarter of 2004 compared to the same

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

period in 2003. Interest expense increased \$2.9 million to \$6.8 million in the third quarter of 2004 compared to \$3.9 million in the third quarter of 2003, primarily due to an increase in the amortization of deferred debt issuance costs related to our outstanding zero coupon convertible senior notes, partially offset by lower other statutory interest expense. During the third quarter of 2004, we accelerated our amortization of debt issuance costs to a more conservative view, electing to amortize such costs related to our outstanding zero coupon convertible senior notes over the five year period from date of issuance to the first note holder put date in November 2007 instead of over the 20 year life of the notes. As a result, we recorded an adjustment for the cumulative difference in amortized debt issuance costs as of the beginning of the third quarter of 2004 of \$3.1 million. The impact of this adjustment is immaterial to our consolidated financial statements for the three and nine month periods ended September 24, 2004 and September 26, 2003, respectively.

We recorded an unrealized loss on derivative instruments of \$0.1 million in the third quarter of 2004 compared to an unrealized gain of \$0.1 million in the third quarter of 2003. We record as Unrealized gain (loss) on derivative instruments, net the mark to market adjustments on our outstanding foreign currency options, which we enter into to reduce the volatility of expected earnings in currencies other than U.S. dollars. Gain on investments in the third quarter of 2004 was zero compared to a gain of \$0.2 million in the same period last year. Other, net income was \$3.6 million in the third quarter of 2004 compared to net expenses of \$1.0 million in the third quarter of 2003. In the third quarter of 2004, Other, net includes a gain of \$5.0 million for the receipt of a technology transfer fee related to the assignment of a third party patent licensing arrangement covering the use of botulinum toxin type B for cervical dystonia, partially offset by net realized losses from foreign currency transactions of \$1.3 million. Other, net in the third quarter of 2003 includes net realized losses from foreign currency transactions of \$0.5 million and \$0.4 million of expenses related to accruals for the settlement of foreign tax compliance matters in Latin America.

Total net non-operating expenses in the first nine months of 2004 were \$5.0 million compared to expenses of \$4.0 million in the first nine months of 2003. Interest income in the first nine months of 2004 was \$6.8 million compared to interest income of \$10.7 million in the same period last year. The decrease in interest income in the first nine months of 2004 was primarily due to lower average cash equivalent balances earning interest of approximately \$144 million in 2004 compared to 2003 and lower average interest rates earned on all cash equivalent balances earning interest of approximately 0.60%. Interest expense increased \$2.0 million to \$14.2 million in the first nine months of 2004 compared to \$12.2 million in the first nine months of 2003, primarily due to an increase in the amortization of deferred debt issuance costs, as discussed in the analysis of the third quarter, partially offset by lower other statutory interest expense.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

During the first nine months of 2004, we recorded a net unrealized gain on derivative instruments of \$0.1 million compared to a net unrealized loss of \$0.9 million during the first nine months of 2003. Other, net income was \$2.3 million for the first nine months of 2004 compared to Other, net expenses of \$1.6 million for the nine months ended September 26, 2003. In the first nine months of 2004, Other, net includes net realized losses from foreign currency transactions of \$3.3 million, a gain of \$5.0 million for the receipt of a technology transfer fee, as discussed in the analysis of the third quarter, and a gain of \$0.8 million realized from the settlement of a non-income tax dispute with Advanced Medical Optics, Inc. For the nine months ended September 26, 2003, Other, net includes \$1.8 million of expenses related to accruals for the settlement of foreign tax compliance matters in Latin America and Europe, partially offset by net realized gains from foreign currency transactions of \$0.9 million.

The effective tax rates for the third quarter and first nine months of 2004 were 30.4% and 28.5%, respectively, compared to the effective tax rates of 28.0% and (69.2)% for the third quarter and first nine months of 2003, respectively. Included in the provision for income taxes in the nine months ended September 24, 2004 is an estimated \$6.1 million income tax benefit for previously paid state income taxes, which became recoverable due to a favorable state court decision that became final during the second quarter of 2004. Excluding the impact of the \$6.1 million income tax benefit, our adjusted effective tax rate for the first nine months of 2004 was 30.2%. Included in the nine months ended September 26, 2003 is a \$278.8 million pre-tax charge for in-process research and development associated with our acquisition of Bardeen Sciences Company. We recorded an income tax benefit for this charge of \$100.8 million. Excluding the impact of the \$278.8 million in-process research and development charge and related tax benefit of \$100.8 million, our adjusted effective tax rate for the nine month period ended September 26, 2003 was 28.0%.

Our adjusted effective tax rate of 30.2% for the first nine months of 2004 increased 1.5 percentage points compared to our full year 2003 adjusted effective tax rate of 28.7%, which excludes the impact of in-process research and development charges of \$458.0 million and related tax benefits of \$100.8 million in 2003. The increase in our estimated annual effective tax rate in 2004 is primarily due to the expected mid-year 2004 expiration of the U.S. research and development tax credit and the fact that our 2003 rate reflected the benefit of reserves for tax audit settlements, which were released in 2003, partially offset by a positive tax rate effect from expected changes in the mix of our earnings during 2004 compared to 2003. On October 4, 2004, the Working Families Tax Relief Act of 2004 was enacted in the United States. This law extends the U.S. research and development tax credit from July 1, 2004 until December 31, 2005.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

RESULTS OF OPERATIONS (Continued)

Because this change in tax law was not enacted until after the close of our 2004 third fiscal quarter, we cannot reflect the related positive impact to our estimated annual effective tax rate in our reported results until our 2004 fourth fiscal quarter. As a sensitivity measure, we believe the effect of this change in law will reduce our full year 2004 effective tax rate by approximately 0.6% on a stand alone basis ignoring the impact of any other changes in estimated tax provision assumptions that may occur during our 2004 fourth fiscal quarter. Our effective tax rate may be subject to fluctuations during the current fiscal year as new information is obtained, which may affect the assumptions we use to estimate our annual effective tax rate.

Net earnings in the third quarter of 2004 were \$92.0 million compared to net earnings of \$76.0 million for the same period last year. The \$16.0 million increase in earnings in the third quarter of 2004 compared to the third quarter of 2003 was primarily the result of the increase in operating income of \$24.8 million and the decrease in total net non-operating expenses of \$1.3 million, partially offset by the increase in the provision for income taxes of \$10.5 million.

Net earnings in the first nine months of 2004 were \$264.6 million, compared to net earnings of \$38.3 million for the same period last year. The \$226.3 million increase in earnings in the first nine months of 2004 compared to the first nine months of 2003 was primarily the result of the increase in operating income of \$348.7 million, partially offset by the increase in total net non-operating expenses of \$1.0 million and an increase in the provision for income taxes of \$122.0 million.

LIQUIDITY AND CAPITAL RESOURCES

Management assesses our liquidity by our ability to generate cash to fund our 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 our stock repurchase program; funds required for acquisitions; adequate credit facilities; and financial flexibility to attract long-term capital on satisfactory terms.

Historically, we have generated cash from operations in excess of working capital requirements. The net cash provided by operating activities for the nine months ended September 24, 2004 was \$375.1 million compared to cash provided of \$291.8 million for the nine months ended September 26, 2003. The increase in net cash provided by operating activities of \$83.3 million was primarily due to the increase in earnings, including the effect of non-cash items, a decrease in interest paid, a decrease in other current assets and an increase in accrued expenses and other liabilities, accounts payable and income taxes payable. These increases in operating cash flow were partially offset by an increase in trade receivables, principally in the

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

United States, an increase in inventories, primarily for eye care pharmaceuticals, *Botox*® and non-pharmaceutical products to be supplied to Advanced Medical Optics, Inc., and higher income taxes paid. In the first nine months of 2004 and 2003, we paid pension contributions of \$4.9 million and \$6.0 million, respectively, to our U.S. defined benefit pension plan. In 2004, we expect to pay contributions of between \$13.6 million and \$15.6 million to our U.S. and non-U.S. pension plans and between \$0.6 million and \$0.7 million to our other postretirement plan.

At December 31, 2003, we disclosed consolidated unrecognized net actuarial losses of \$134.8 million, which were included in our reported prepaid benefit cost. The unrecognized actuarial losses resulted primarily from lower than expected investment returns on plan assets in 2002 and 2001 and decreases in the discount rates used to measure projected benefit obligations that occurred over the past three years. Unrecognized net actuarial gains or losses are evaluated annually by our actuaries for each of our pension and postretirement plans based on information at the plans annual measurement date. Assuming constant actuarial assumptions estimated as of our pension plans' measurement date of September 30, 2003, we expect the amortization of these unrecognized actuarial losses to increase our total pension costs by approximately \$3 million in 2004, \$5 million in 2005 and \$6 million in 2006 compared to the amortization of approximately \$3 million of unrecognized actuarial losses included in pension costs expensed in fiscal year 2003. The future amortization of the unrecognized actuarial losses is not expected to materially affect future pension contribution requirements.

Net cash used in investing activities in the first nine months of 2004 was \$70.4 million. Net cash used in investing activities in the first nine months of 2003 was \$324.7 million. Excluding the \$251.8 million in net cash paid in connection with the acquisition of Bardeen Sciences Company, LLC, cash used in investing activities during the first nine months of 2003 would have been \$72.9 million. We invested \$64.0 million in new facilities and equipment during the nine months ended September 24, 2004 compared to \$62.0 million during the same period in 2003. Other, net cash used in investing activities includes \$4.9 million and \$8.7 million to acquire software during the nine months ended September 24, 2004 and September 26, 2003, respectively. We currently expect to invest between \$100 million and \$110 million in construction costs for expansion of manufacturing capacity and laboratory facilities, and other property, plant and equipment during 2004. Although our 2005 budget is not final, we expect capital expenditures to be lower in 2005 than the amounts invested in 2004.

Net cash used in financing activities was \$33.8 million in the first nine months of 2004 compared to cash used of \$26.1 million in the first nine months of 2003. Dividends paid to stockholders were \$35.5 million in the first nine months of 2004 compared to \$35.2 million for the same period in 2003.

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

Effective October 27, 2004 our Board of Directors declared a quarterly cash dividend of \$0.09 per share, payable on December 9, 2004 to stockholders of record on November 10, 2004. Receipts from the sale of stock to employees were \$80.0 million in the first nine months of 2004 compared to \$39.9 million in the same period last year. During the first nine months of 2004, we repaid \$2.7 million in notes payable compared to net borrowings of \$6.6 million in the first nine months of 2003. During the first nine months of 2004, we repaid \$10.4 million under our commercial paper arrangements and repurchased \$65.2 million of treasury stock. We repurchased \$37.4 million of treasury stock in the first nine months of 2003. Under our stock repurchase program, we may maintain up to 9.2 million repurchased shares in our treasury account at any one time. As of September 24, 2004, we held approximately 3.0 million treasury shares under this program. We are uncertain as to the level of treasury stock repurchases to be made in the future.

As of September 24, 2004, we had a committed domestic long-term credit facility, a committed foreign line of credit in Japan, a commercial paper program, a medium-term note program, and an unused debt shelf registration statement that we may use for a new medium-term note program. The committed domestic credit facility allows for borrowings of up to \$400 million through May 2009. The committed foreign line of credit allows for borrowings of up to approximately \$27 million through 2006. The commercial paper program also provides for up to \$300 million in borrowings. We do not currently intend to have combined borrowings under our committed credit facilities and our commercial paper program that would exceed \$300 million in the aggregate. The current medium-term note program allows us to issue up to an additional \$8.7 million in registered notes on a non-revolving basis. The debt shelf registration statement provides for up to \$350 million in additional debt securities. Borrowings under the domestic credit facility and medium-term note program are subject to certain financial and operating covenants that include, among other provisions, maintaining minimum debt to capitalization ratios and a minimum consolidated net worth. Certain covenants also limit subsidiary debt and restrict dividend payments. We were in compliance with these covenants at September 24, 2004. As of September 24, 2004, we had no borrowings under our domestic committed credit facility or commercial paper program, \$9.0 million in borrowings outstanding under our committed foreign line of credit, \$12.6 million outstanding in borrowings under various foreign bank loans and \$56.3 million in borrowings outstanding under the medium-term note program.

On November 6, 2002, we issued zero coupon convertible senior notes due 2022, or Senior Notes, in a private placement with an aggregate principal amount at maturity of \$641.5 million. The Senior Notes, which were issued at a discount of \$141.5 million, are unsecured and accrue interest at 1.25% annually, maturing on November 6, 2022. The Senior Notes are convertible into 11.41 shares of our common stock for each \$1,000 principal amount at maturity if the closing price of our common stock exceeds certain levels,

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

the credit ratings assigned to the Senior Notes are reduced below specified levels, or we call the Senior Notes for redemption, make specified distributions to our stockholders or become a party to certain consolidation, merger or binding share exchange agreements. On July 28, 2004, we, together with Wells Fargo Bank, as trustee, executed a supplemental indenture to the indenture governing the Senior Notes. The supplemental indenture amends the indenture's redemption and conversion provisions to restrict our ability to issue common stock in lieu of cash to holders of the Senior Notes upon any redemption or conversion. Upon any redemption, we are now required to pay the entire redemption amount in cash. In addition, upon any conversion, we will pay cash up to the accreted value of the Senior Notes converted and will have the option to pay any amounts due in excess of the accreted value in either cash or common stock. The rights of the holders of the Senior Notes were not affected or limited by the supplemental indenture. As of September 24, 2004, the conversion criteria had not been met. As a sensitivity measure, the dilutive effect from the assumed conversion of the Senior Notes would have been approximately 1.6 million and 1.7 million shares of common stock for the three and nine month periods ended September 24, 2004, respectively, if the closing price of our common stock during the specified conversion periods averaged \$90.01 per share (the minimum price allowed for conversion during the periods) and any amounts above the accreted value were settled in common stock.

Holders of the Senior Notes may require us to purchase the Senior Notes on any one of the following dates at the following prices: \$829.51 per Senior Note on November 6, 2007; \$882.84 per Senior Note on November 6, 2012; and \$939.60 per Senior Note on November 6, 2017. Pursuant to the supplemental indenture, we are required to pay cash for any Senior Notes purchased by us on any of these three dates. We may not redeem the Senior Notes before November 6, 2005, and prior to November 6, 2007 we may redeem all or a portion of Senior Notes for cash in an amount equal to their accreted value only if the price of our common stock reaches certain thresholds for a specified period of time. On or after November 6, 2007, we may redeem all or a portion of the Senior Notes for cash in an amount equal to their accreted value.

A substantial portion of our existing cash and equivalents are held by non-U.S. subsidiaries. We currently plan to use these funds in our operations outside the United States. Withholding and U.S. taxes have not been provided for unremitted earnings of certain non-U.S. subsidiaries because we have reinvested or expect to reinvest these earnings permanently in such operations. As of December 31, 2003, we had approximately \$712 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.

Allergan, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 24, 2004 (Continued)

LIQUIDITY AND CAPITAL RESOURCES (Continued)

On October 22, 2004, the American Jobs Creation Act of 2004 was enacted in the United States. We are currently evaluating the impact of this new law on our operations and effective tax rate. In particular, we are evaluating the law's provisions relating to incentives to reinvest foreign earnings in the United States, which require a domestic reinvestment plan to be created and approved by our board of directors before executing any repatriation activities. We currently have no plans to change our policy regarding permanent reinvestment of unremitted earnings in our foreign operations. We are also evaluating allowable deductions, beginning in 2005, for income attributable to United States production activities. At this time, we are unable to determine the effects of this new law and will continue to analyze its potential impact as guidance is made available.

Our manufacturing and supply agreement with Advanced Medical Optics, Inc. is scheduled to terminate on June 28, 2005. We currently estimate that we will incur between \$24 million and \$28 million of additional restructuring costs associated with the termination of that agreement and related exit activities. We expect to begin incurring these costs in the fourth quarter of 2004 and expect to complete the additional restructuring activities by the end of the fourth quarter of 2005.

We believe that the net cash provided by operating activities, supplemented as necessary with borrowings available under our existing credit facilities and existing cash and equivalents, will provide us with sufficient resources to meet working capital requirements, debt service and other cash needs over the next year.

ALLERGAN, INC.

Item 3. Quantitative and Qualitative Disclosures About Market Risk and Certain Factors and Trends Affecting Allergan and its Businesses

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, our operations are exposed to risks associated with fluctuations in foreign currency exchange rates. We address these risks through controlled risk management that includes the use of derivative financial instruments to economically hedge or reduce these exposures. We do not enter into financial instruments for trading or speculative purposes.

To ensure the adequacy and effectiveness of our foreign exchange hedge positions, we continually monitor our foreign exchange forward and option positions both on a stand-alone basis and in conjunction with our 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, we cannot assure you that such programs will offset more than a portion of the adverse financial impact resulting from unfavorable movements in 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 our consolidated operating results and financial position.

We record current changes in the fair value of open foreign currency option contracts as Unrealized gains (losses) on derivative instruments, net and record the gains and losses realized from settled option contracts in Other, net in the accompanying unaudited condensed consolidated statements of earnings. The premium costs of purchased foreign exchange option contracts are recorded in Other current assets and are amortized to Other, net over the life of the options. We have recorded all unrealized and realized gains and losses from foreign currency forward contracts through Other, net in the accompanying unaudited condensed consolidated statements of earnings.

Interest Rate Risk

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

At September 24, 2004, we had approximately \$20.1 million of variable rate debt. If the interest rates on our variable rate debt were to increase or decrease by 1% for the year, annual interest expense would increase or decrease by approximately \$0.2 million.

Allergan, Inc.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

The tables below present information about certain of our investment portfolio and our debt obligations at September 24, 2004 and December 31, 2003.

SEPTEMBER 24, 2004

	Maturing in					Total	Fair Market Value
	2004	2005	2006	2007	2008		
(in millions, except interest rates)							
ASSETS							
Cash equivalents:							
Repurchase Agreements	\$ 100.0					\$ 100.0	\$ 100.0
Weighted Average Interest Rate	1.55%					1.55%	
Commercial Paper	531.1					531.1	531.1
Weighted Average Interest Rate	4.48%					4.48%	
Foreign Time Deposits	51.7					51.7	51.7
Weighted Average Interest Rate	1.60%					1.60%	
Other Cash Equivalents	27.8					27.8	27.8
Weighted Average Interest Rate	1.59%					1.59%	
Total Cash Equivalents	\$ 710.6					\$ 710.6	\$ 710.6
Weighted Average Interest Rate	3.75%					3.75%	
LIABILITIES							
Debt Obligations:							
Fixed Rate (US\$)			\$ 512.0	\$ 31.3	\$ 25.0	\$ 568.3	\$ 676.7
Weighted Average Interest Rate			1.25%	3.56%	7.47%	1.65%	
Other Fixed Rate (non-US\$)	\$ 1.5					1.5	1.5
Weighted Average Interest Rate	13.25%					13.25%	
Other Variable Rate (non-US\$)	20.1					20.1	20.1
Weighted Average Interest Rate	1.97%					1.97%	
	\$ 21.6		\$ 512.0	\$ 31.3	\$ 25.0	\$ 589.9	\$ 698.3

**Total Debt
Obligations
Weighted Average
Interest Rate**

2.75%

1.25%

3.56%

7.47%

1.69%

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Allergan, Inc.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

DECEMBER 31, 2003

	Maturing in					Total	Fair Market Value
	2004	2005	2006	2007	2008		
(in millions, except interest rates)							
ASSETS							
Cash equivalents:							
Repurchase Agreements	\$ 150.0					\$ 150.0	\$ 150.0
Weighted Average Interest Rate	1.18%					1.18%	
Commercial Paper	252.8					252.8	252.8
Weighted Average Interest Rate	1.07%					1.07%	
Foreign Time Deposits	59.5					59.5	59.5
Weighted Average Interest Rate	2.23%					2.23%	
Total Cash Equivalents	\$ 462.3					\$ 462.3	\$ 462.3
Weighted Average Interest Rate	1.25%					1.25%	
LIABILITIES							
Debt Obligations:							
Fixed Rate (US\$)			\$ 507.3	\$ 30.6	\$ 25.0	\$ 562.9	\$ 674.7
Weighted Average Interest Rate			1.25%	3.56%	7.47%	1.65%	
Other Fixed Rate (non-US\$)	\$ 1.9					1.9	1.9
Weighted Average Interest Rate	11.89%					11.89%	
Variable Rate (US\$)			10.4			10.4	10.4
Weighted Average Interest Rate			1.05%			1.05%	
Other Variable Rate (non-US\$)	22.5					22.5	22.5
Weighted Average Interest Rate	2.04%					2.04%	
Total Debt Obligations	\$ 24.4		\$ 517.7	\$ 30.6	\$ 25.0	\$ 597.7	\$ 709.5
Weighted Average Interest Rate	2.81%		1.25%	3.56%	7.47%	1.69%	

Foreign Currency Risk

Overall, we are a net recipient of currencies other than the U.S. dollar and, as such, benefit from a weaker dollar and are adversely affected by a stronger dollar relative to major currencies worldwide. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may negatively affect our consolidated sales and gross margins as expressed in U.S. dollars.

From time to time, we enter into foreign currency option and foreign currency forward contracts to reduce earnings and cash flow volatility associated with foreign exchange rate changes to allow our management to focus its attention on our core business issues and challenges. Accordingly, we enter into various contracts which change in value as foreign exchange rates change to economically offset the effect of changes in the value of foreign currency assets and liabilities, commitments and anticipated foreign currency denominated sales and operating expenses. We enter into foreign currency option and foreign currency forward contracts in amounts between minimum and maximum anticipated foreign exchange exposures, generally for periods not to exceed one year.

Allergan, Inc.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

We use foreign currency option contracts, which provide for the sale of foreign currencies to offset foreign currency exposures expected to arise in the normal course of our business. While these instruments are subject to fluctuations in value, such fluctuations are anticipated to offset changes in the value of the underlying exposures. The principal currencies subject to this process are the Canadian dollar, Mexican peso, Australian dollar, Brazilian real, euro and the Japanese yen.

All of our outstanding foreign exchange forward contracts are entered into to protect the value of intercompany receivables denominated in currencies other than the lender's functional currency. The realized and unrealized gains and losses from foreign currency forward contracts and the revaluation of the foreign denominated intercompany receivables are recorded through Other, net in the accompanying unaudited condensed consolidated statements of earnings.

The following tables provide information about our foreign currency derivative financial instruments outstanding as of September 24, 2004 and December 31, 2003. The information is provided in U.S. dollar amounts, as presented in our consolidated financial statements.

	September 24, 2004		December 31, 2003	
	Notional Amount	Average Contract Rate or Strike Amount	Notional Amount	Average Contract Rate or Strike Amount
	(in millions)		(in millions)	
Foreign currency forward contracts: (Receive US\$/Pay Foreign Currency)				
Euros	\$5.8	1.23	\$11.9	1.22
U.K. Pound	—		0.5	1.73
	\$5.8		\$12.4	
Estimated fair value	\$		\$ (0.4)	

Allergan, Inc.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

	September 24, 2004		December 31, 2003	
	Notional Amount	Average Contract Rate or Strike Amount	Notional Amount	Average Contract Rate or Strike Amount
	(in millions)		(in millions)	
Foreign currency purchased put options:				
Canadian Dollar	\$ 4.9	1.34	\$16.4	1.36
Mexican Peso	4.0	11.70	10.5	11.54
Australian Dollar	3.1	0.71	10.9	0.67
Brazilian Real	1.9	3.32	5.8	3.36
Euro	2.4	1.21	3.6	1.21
Japanese Yen	2.6	106.56	3.3	106.65
	<u>18.9</u>		<u>50.5</u>	
Estimated fair value	<u>\$ 0.2</u>		<u>\$ 1.0</u>	
Foreign currency sold cash options:				
Euro	<u>\$</u>		<u>\$ 5.7</u>	1.18
Estimated fair value	<u>\$</u>		<u>\$ 0.3</u>	

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES

Statements made by us in this report and in other reports and statements released by us that are not historical facts constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21 of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. These forward-looking statements are necessarily estimates reflecting the best judgment of senior management and include comments that express our opinions about trends and factors that may impact future operating results. Disclosures that use words such as we believe, anticipate, estimate, intend, could, plan, expect and similar expressions are intended to constitute forward-looking statements. Such statements rely on a number of assumptions concerning future events, many of which are outside of our control, and involve risks and uncertainties that could cause actual results to differ materially from opinions and expectations. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in context of the various disclosures made by us about our businesses including, without limitation, the risk factors discussed below. We do not plan to update any such forward-looking statements and expressly disclaim any duty to update the information contained in this filing except as required by law.

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

We operate in a highly competitive business.

The pharmaceutical industry is highly competitive. This competitive environment requires an ongoing, extensive search for technological innovation. It also requires, among other things, the ability to effectively develop, test, and obtain regulatory approvals for products, as well as the ability to effectively commercialize, market and promote approved products, including communicating the effectiveness, safety and value of products to actual and prospective customers and medical professionals. Many of our competitors have greater resources than we have. This enables them, among other things, to spread their research and development costs, as well as their marketing and promotion costs, over a broader revenue base. Our competitors may also have more experience and expertise in obtaining marketing approvals from the FDA and other regulatory authorities. In addition to product development, testing, approval and promotion, other competitive factors in the pharmaceutical industry include industry consolidation, product quality and price, reputation, customer service and access to technical information. It is possible that developments by our competitors could make our products or technologies less competitive or obsolete. In addition, competition from generic drug manufacturers is a major challenge in the United States and is growing internationally. For instance, Falcon Pharmaceuticals, Ltd., an affiliate of Alcon Laboratories, Inc., is currently attempting to obtain FDA approval for and to launch a brimonidine product to compete with our *Alphagan*® P product.

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

Until December 2000, *Botox*® was the only neuromodulator approved by the FDA. At that time, the FDA approved *Myobloc*®, a neuromodulator formerly marketed by Elan Pharmaceuticals and now marketed by Solstice Neurosciences Inc. We believe that Beaufour Ipsen Ltd. intends to seek FDA approval of its *Dysport*® neuromodulator for certain therapeutic indications, and that Beaufour Ipsen's marketing partner, Inamed Corporation, intends to seek FDA approval of *Dysport*® for cosmetic indications. Beaufour Ipsen has marketed *Dysport*® in Europe since 1991, prior to our European commercialization of *Botox*® in 1992. Also, we believe that Mentor Corporation intends to develop and seek regulatory approval to market a competing neuromodulator in the United States. In addition, we are aware of competing neuromodulators currently being developed and commercialized in Asia, Europe, South America and other markets. A Chinese entity received approval to market a botulinum toxin in China in 1997, and we believe that it has launched or is planning to launch its botulinum toxin product in other lightly regulated markets in Asia, South America and Mexico. These lightly regulated markets may not require adherence to the FDA's current Good Manufacturing Practices, or cGMPs, the European Medical Evaluation Agency or other regulatory agencies in countries that are members of the Organization for Economic Cooperation and Development, and companies operating in these markets may be able to produce products at a lower cost than we can. In addition, a German company is seeking German regulatory approval for a botulinum toxin currently expected to be launched during the second half of 2005, and a Korean company is developing a botulinum toxin currently expected to be launched in Korea during 2004. Our sales of *Botox*® could be materially and negatively impacted by this competition or competition from other companies that might obtain FDA approval or approval from other regulatory authorities to market a neuromodulator.

Botox® Cosmetic is a consumer product, trends may change and applicable laws may affect sales or product margins of *Botox*® or *Botox*® Cosmetic.

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

Demand for *Botox*® Cosmetic, like other cosmetic products, may be adversely affected by changing economic conditions to a greater extent than demand for therapeutic products. Generally, the costs of cosmetic products and procedures are borne by individuals without reimbursement from their medical insurance providers or government programs. Individuals may be less willing to incur the costs of these products or procedures in weak or uncertain economic environments, and demand for *Botox*® Cosmetic could be adversely affected.

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

Because *Botox*® and *Botox*® Cosmetic are pharmaceutical products, we generally do not collect or pay sales tax on sales of *Botox*® or *Botox*® Cosmetic. We could be required to collect and pay sales tax associated with prior, current or future years on sales of *Botox*® or *Botox*® Cosmetic. In addition to any retroactive taxes and corresponding interest and penalties that could be assessed, if we were required to collect or pay sales tax associated with current or future years on sales of *Botox*® or *Botox*® Cosmetic, our sales of, or our product margins on, *Botox*® or *Botox*® Cosmetic could be adversely affected due to the increased cost associated with those products.

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

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

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

Our future performance will be affected by the market acceptance of products such as *Lumigan*®, *Alphagan*® P, *Restasis*®, *Zymar*® and *Botox*®, as well as FDA approval of new indications for products such as *Botox*®, *Combigan*®, our *Lumigan*®/*Timolol* combination, Inspire Pharmaceuticals' diquafosol tetrasodium product for the treatment of dry eye, and the oral formulation of *Tazorac*®. We have allocated substantial resources to the development and introduction of new products and indications. New products must be continually developed, tested and manufactured and, in addition, must meet regulatory standards and receive requisite regulatory approvals in a timely manner. For instance, to obtain approval of new indications or products in the United States, we must submit, among other information, the results of preclinical and clinical studies on the new indication or product candidate to the FDA. The number of preclinical and clinical studies that will be required for FDA approval varies depending on the new indication or product candidate, the disease or condition for which the new indication or product candidate is in development and the regulations applicable to that new indication or product candidate. For example, an FDA advisory panel recently voted against approval for the oral formulation of *Tazorac*®, and we subsequently received a non-approvable letter from the FDA for that product. If the FDA delays or does not approve of new indications for our products or drug candidates, the price per share of our common stock may be impacted upon the announcement of such delays or non-approvals. We are also required to pass pre-approval reviews and plant inspections of our and our suppliers' facilities to demonstrate our compliance with the FDA's cGMP regulations. Products that we are currently developing or other future product candidates may or may not receive the regulatory approvals necessary for marketing. Furthermore, the development, regulatory review and approval, and commercialization processes are time consuming, costly and subject to numerous factors that may delay or prevent

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

the development and commercialization of new products, including legal actions brought by our competitors. The FDA can delay, limit or deny approval of a new indication or product candidate for many reasons, including:

- a determination that the new indication or product candidate is not safe and effective;
- the FDA may interpret our preclinical and clinical data in different ways than we do;
- the FDA may not approve our manufacturing processes or facilities; or
- the FDA may change its approval policies or adopt new regulations.

In connection with our acquisitions of Bardeen Sciences Company, LLC and Oculex Pharmaceuticals, Inc., we acquired the right to continue researching and developing certain compounds and products, respectively, for commercialization. We cannot assure you that these or any other compounds or products that we are developing for commercialization will be able to be commercialized on terms that will be profitable or at all. If any of our products cannot be successfully or timely commercialized, our operating results could be materially adversely affected. Delays or unanticipated costs in any part of the process or our inability to obtain timely regulatory approval for our products, including those attributable to our failure to maintain manufacturing facilities in compliance with all applicable regulatory requirements, could cause our operating results to suffer and our stock price to decrease. We cannot assure you that new products or indications will be successfully developed, will receive regulatory approval or will achieve market acceptance. Further, even if we receive FDA and other regulatory approvals for a new indication or product, the product may later exhibit adverse effects that limit or prevent its widespread use or that force us to withdraw the product from the market or to revise our labeling to limit the indications for which the product may be prescribed.

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

Patent protection is generally important in the pharmaceutical industry. Upon the expiration or loss of patent protection for a product, we can lose a significant portion of sales of that product in a very short period of time as other companies manufacture generic forms of our previously protected product at lower cost, without having had to incur significant research and development costs in formulating the product. Therefore, our future financial success may depend in part on obtaining patent protection for technologies incorporated into our products. We cannot assure you that such patents will be issued, or that any existing or future patents will be of commercial benefit. In addition, it is impossible to anticipate the breadth or degree of protection that any such patents will afford, and we cannot assure you that any such patents will not be successfully challenged in the future. If we are unsuccessful in obtaining or preserving patent protection, or if any of our products rely on unpatented proprietary

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

technology, we cannot assure you that others will not commercialize products substantially identical to those products. Generic drug manufacturers are currently challenging the patents covering certain of our products and we expect that they will continue to do so in the future. Our business also relies on trade secrets and proprietary know-how that we seek to protect, in part, through confidentiality agreements with third parties, including our partners, customers, employees and consultants. It is possible that these agreements will be breached or that they will not be enforceable in every instance, and that we will not have adequate remedies for any such breach. It is also possible that our trade secrets will become known or independently developed by our competitors.

Interruptions in the supply of raw materials could disrupt our manufacturing and cause our sales and profitability to decline.

We obtain the specialty chemicals that are the active pharmaceutical ingredients in certain of our products from single sources, who must maintain compliance with the FDA's cGMP regulations. If we experience difficulties acquiring sufficient quantities of these materials from our existing suppliers, or if our suppliers are found to be non-compliant with cGMPs, obtaining the required regulatory approvals, including from the FDA, to use alternative suppliers may be a lengthy and uncertain process. A lengthy interruption of the supply of one or more of these materials could adversely affect our ability to manufacture and supply commercial product, which could cause our sales and profitability to decline.

Importation of products from Canada and other countries into the United States may lower the prices we receive for our products.

In the United States, our products are subject to competition from lower priced versions of our products and competing products from Canada, Mexico, and other countries where government price controls or other market dynamics result in lower prices. Our products that require a prescription in the United States are often available to consumers in these markets without a prescription, which may cause consumers to further seek out our products in these lower priced markets. The ability of patients and other customers to obtain these lower priced imports has grown significantly as a result of the Internet, an expansion of pharmacies in Canada and elsewhere targeted to American purchasers, the increase in U.S.-based businesses affiliated with Canadian pharmacies marketing to American purchasers, and other factors. Most of these foreign imports are illegal under current U.S. law. However, the volume of imports continues to rise due to the limited enforcement resources of the FDA and the U.S. Customs Service, and there is increased political pressure to permit the imports as a mechanism for expanding access to lower priced medicines.

In December 2003, Congress enacted the Medicare Prescription Drug, Improvement and Modernization Act of 2003. This law contains provisions that may change U.S. import laws and expand consumers' ability to import lower priced versions of our and competing products from Canada, where there are government price controls. These changes to U.S. import laws will not take effect unless and until the Secretary of Health and Human Services certifies that the changes will lead to substantial savings for consumers.

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

and will not create a public health safety issue. The current Secretary of Health and Human Services has indicated that there is not a basis to make such a certification at this time. However, it is possible that this Secretary or a subsequent Secretary could make the certification in the future. As directed by Congress, the current Secretary has created a task force on drug importation, which will conduct a comprehensive study regarding the circumstances under which drug importation could be safely conducted and the consequences of importation on the health, medical costs and development of new medicines for U.S. consumers. The results of this study, due at the end of 2004, may affect this or a subsequent Secretary's ability to make the required certification. In addition, federal legislative proposals have been made to implement the changes to the U.S. import laws without any certification, and to broaden permissible imports in other ways. Even if the changes to the U.S. import laws do not take effect, and other changes are not enacted, imports from Canada and elsewhere may continue to increase due to market and political forces, and the limited enforcement resources of the FDA, the U.S. Customs Service, and other government agencies. For example, state and local governments have suggested that they may import drugs from Canada for employees covered by state health plans or others, and some already have implemented such plans.

The importation of foreign products adversely affects our profitability in the United States. This impact could become more significant in the future, and the impact could be even greater if there is a further change in the law or if state or local governments take further steps to import products from abroad.

Our business will continue to expose us to risks of environmental liabilities.

Our product development programs and manufacturing processes involve the controlled use of hazardous materials, chemicals and toxic compounds. These programs and processes expose us to risks that an accidental contamination could lead to noncompliance with environmental laws, regulatory enforcement actions and claims for personal injury and property damage. If an accident occurs, or if we discover contamination caused by prior operations, including by prior owners and operators of properties we acquire, we could be liable for cleanup obligations, damages and fines. The substantial unexpected costs we may incur could have a significant and adverse effect on our business and results of operations.

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

The design, development, manufacture and sale of our products involve an inherent risk of product liability claims by consumers and other third parties. We have in the past been, and continue to be, subject to various product liability claims. In addition, we have in the past and may in the future recall or issue field corrections related to our products due to manufacturing deficiencies, labeling errors or other safety or regulatory reasons. We cannot assure you that we will not experience material losses due to product liability claims, product recalls or corrections.

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

Additionally, our products may cause, or may appear to cause, serious adverse side effects or potentially dangerous drug interactions if misused or improperly prescribed. These events, among others, could result in additional regulatory controls, such as the performance of costly post-approval clinical studies or revisions to our approved labeling that could limit the indications or patient population for our products or could even lead to the withdrawal of a product from the market. Furthermore, any adverse publicity associated with such an event could cause consumers to seek alternatives to our products, which may cause our sales to decline, even if our products are ultimately determined not to have been the primary cause of the event.

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

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

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

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

We are subject to risks associated with doing business internationally.

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

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

adverse changes in tariff and trade protection measures;
unexpected changes in foreign regulatory requirements;
potentially negative consequences from changes in or interpretations of tax laws;
differing labor regulations;
changing economic conditions in countries where our products are sold or manufactured or in other countries;
differing local product preferences and product requirements;
exchange rate risks;
restrictions on the repatriation of funds;
political unrest and hostilities;
differing degrees of protection for intellectual property; and
difficulties in coordinating and managing foreign operations.

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

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

Although we have a corporate policy not to infringe the valid and enforceable patents of others, we cannot assure you that our products will not infringe patents held by third parties. In the event we discover that we may be infringing third party patents, licenses from those third parties may not be available on commercially attractive terms or at all. We may have to defend, and have recently defended, against charges that we violated patents or the proprietary rights of third parties. Litigation is costly and time-consuming, and diverts the attention of our management and technical personnel. In addition, if we infringe the intellectual property rights of others, we could lose our right to develop, manufacture or sell products or could be required to pay monetary damages or royalties to license proprietary rights from third parties. An adverse determination in a judicial or administrative proceeding or a failure to obtain necessary licenses could prevent us from manufacturing or selling our products, which could harm our business, financial condition, prospects, results of operations and cash flows. See Part II, Item 1, Legal Proceedings and Note 7,

Litigation, in the notes to unaudited condensed consolidated financial statements listed under Item 1(D) of Part I of this report for information on current patent litigation.

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

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

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

pharmaceutical manufacturers, including us. In addition, wholesaler purchases may exceed customer demand, resulting in reduced wholesaler purchases in later quarters. We cannot assure you that wholesaler purchases will not decrease as a result of this potential excess buying.

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

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

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

Extensive industry regulation has had, and will continue to have, a significant impact on our business, especially our product development and manufacturing capabilities. All pharmaceutical companies, including Allergan, are subject to extensive, complex, costly and evolving regulation by federal governmental authorities, principally by the FDA and the U.S. Drug Enforcement Administration, and similar foreign and state government agencies. Failure to comply with the regulatory requirements of the FDA and other U.S. and foreign regulatory requirements may subject a company to administrative or judicially imposed sanctions, including, among others, a refusal to approve a pending application to market a new product or a new indication for an existing product. The Federal Food, Drug, and Cosmetic Act, the Controlled Substances Act and other domestic and foreign statutes and regulations govern or influence the research, testing, manufacturing, packing, labeling, storing, record keeping, safety, effectiveness, approval, advertising, promotion, sale and distribution of our products. Under certain of these regulations, we are subject to periodic inspection of our facilities, production processes and control operations and/or the testing of our products by the FDA, the U.S. Drug Enforcement Administration and other authorities, to confirm that we are in compliance with all applicable regulations, including the FDA's cGMP regulations. The FDA conducts pre-approval and post-approval reviews and plant inspections

ALLERGAN, INC.

CERTAIN FACTORS AND TRENDS AFFECTING ALLERGAN AND ITS BUSINESSES (Continued)

of us and our suppliers to determine whether our record keeping, production processes and controls, personnel and quality control are in compliance with cGMPs and other FDA regulations. We also need to perform extensive audits of our vendors, contract laboratories and suppliers to ensure that they are compliant with these requirements. In addition, in order to commercialize our products or new indications for an existing product, we must demonstrate that the product or new indication is safe and effective, and that our and our suppliers' manufacturing facilities are compliant with applicable regulations, to the satisfaction of the FDA and other regulatory agencies.

The process for obtaining governmental approval to manufacture pharmaceutical products is rigorous, typically takes many years and is costly, and we cannot predict the extent to which we may be affected by legislative and regulatory developments. We are dependent on receiving FDA and other governmental approvals prior to manufacturing, marketing and shipping our products. Consequently, there is always a risk that the FDA or other applicable governmental authorities will not approve our products, or will take post-approval action limiting or revoking our ability to sell our products, or that the rate, timing and cost of such approvals will adversely affect our product introduction plans, results of operations and stock price. Despite the time and expense exerted, regulatory approval is never guaranteed.

Even after we obtain regulatory approval for a product candidate or new indication, we are subject to extensive regulation, including ongoing compliance with the FDA's cGMP regulations, post-marketing clinical studies mandated by the FDA, adverse event reporting, labeling, advertising, marketing and promotion. If we or any third party that we involve in the testing, packing, manufacture, labeling, marketing and distribution of our products fail to comply with any such regulations, we may be subject to, among other things, warning letters, product seizures, recalls, fines or other civil penalties, injunctions, suspension or revocation of approvals, operating restrictions and criminal prosecution. Physicians may prescribe pharmaceutical or biologic products for uses that are not described in a product's labeling or differ from those tested by us and approved by the FDA. While such off-label uses are common and the FDA does not regulate a physician's choice of treatment, the FDA does restrict a manufacturer's communications on the subject of off-label use. Companies cannot actively promote FDA-approved pharmaceutical or biologic products for off-label uses, but they may disseminate to physicians articles published in peer-reviewed journals. To the extent allowed by law, we disseminate peer-reviewed articles on our products to targeted physicians. If, however, our promotional activities fail to comply with the FDA's regulations or guidelines, we may be subject to warnings from, or enforcement action by, the FDA or another enforcement agency.

ALLERGAN, INC.

ITEM 4. Controls and Procedures
CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Our management, including our Principal Executive Officer and our Principal Financial Officer, does not expect that our disclosure controls or procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Allergan have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Also, we have investments in certain unconsolidated entities. As we do not control or manage these entities, our disclosure controls and procedures with respect to such entities are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

We carried out an evaluation, under the supervision and with the participation of our management, including our Principal Executive Officer and our Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 24, 2004, the end of the quarterly period covered by this report. Based on the foregoing, our Principal Executive Officer and our Principal Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in the Company's internal controls over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Allergan, Inc.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

Litigation

The following supplements and amends the Company's discussion set forth under Part I, Item 3, Legal Proceedings in the Company's Annual Report on Form 10-K for the year ended December 31, 2003 and Part II, Item 1 in the Company's Quarterly Report on Form 10-Q for the quarter ended June 25, 2004.

On June 6, 2001, after receiving paragraph 4 invalidity and noninfringement Hatch-Waxman Act certifications from Apotex indicating that Apotex had filed an Abbreviated New Drug Application with the FDA for a generic form of *Acular*®, we and Syntex, the holder of the *Acular*® patent, filed a lawsuit entitled *Syntex (U.S.A.) LLC and Allergan, Inc. v. Apotex, Inc., et al.* in the United States District Court for the Northern District of California. On December 29, 2003, after a trial in June 2003, the court entered Findings of Fact and Conclusions of Law in our favor, thereby holding that the patent at issue is valid, enforceable and infringed by Apotex's proposed generic drug. On January 27, 2004, the court entered final judgment in our favor. On February 17, 2004, Apotex filed a Notice of Appeal with the United States Court of Appeals for the Federal Circuit. The parties have submitted their appeal briefs to the United States Court of Appeals for the Federal Circuit. Oral argument on the appeal is scheduled for November 1, 2004. On June 29, 2001, we filed a separate lawsuit in Canada against Apotex similarly relating to a generic version of *Acular*®. A mediation in the Canadian lawsuit has been scheduled for December 20, 2004 and a settlement conference has been scheduled for April 6, 2005.

On January 23, 2003, a complaint entitled *Irena Medavoy and Morris Mike Medavoy v. Arnold W. Klein, M.D., et al. and Allergan, Inc.* was filed in the Superior Court of the State of California for the County of Los Angeles. The complaint contained, among other things, allegations against us of negligence, unfair business practices, product liability, intentional misconduct, fraud, negligent misrepresentation, strict liability in tort, improper off-label promotion and loss of consortium. The complaint also contained separate allegations against the other defendants. On April 10, 2003, Morris Mike Medavoy voluntarily served on us a Request for Dismissal Without Prejudice for the only two causes of action he asserted in the complaint. The causes of action asserted by Irena Medavoy against us were not affected by this Request for Dismissal. On July 8, 2003, Irena Medavoy filed a First Amended Complaint, adding allegations against us of false and/or misleading advertising and unjust enrichment, as well as false and/or misleading advertising and unfair competition. A jury trial

Allergan, Inc.

Litigation (Continued)

in the matter began on August 31, 2004. On October 8, 2004, the jury ruled in favor of us and Dr. Klein. Also on October 8, 2004, the court dismissed the unfair business practices claims against us and Dr. Klein.

On May 17, 2004, a complaint entitled *Utility Consumers Action Network v. Allergan, Inc., et al.* was filed in the Superior Court of the State of California for the County of San Diego. The complaint names us and several other defendants. We were served with the complaint on July 15, 2004. The complaint alleges unfair business practices and untrue or misleading advertising in violation of the California Business and Professions Code.

On July 13, 2004, we received a paragraph 4 invalidity and noninfringement Hatch-Waxman Act certification from Alcon, Inc. indicating that Alcon had filed a New Drug Application (NDA) under section 505(b)(2) of the Federal Food, Drug and Cosmetic Act for a drug containing brimonidine tartrate ophthalmic solution in a 0.15% concentration. In the certification, Alcon contends that U.S. Patent Nos. 5,424,078; 6,562,873; 6,627,210; 6,641,834; and 6,673,337, all of which are assigned to us or our wholly-owned subsidiary, Allergan Sales, LLC, and are listed in the Orange Book under *Alphagan*® P, are invalid and/or not infringed by the proposed Alcon product. On August 24, 2004, we filed a complaint against Alcon for patent infringement in the United States District Court for the District of Delaware. On September 3, 2004, Alcon filed an answer to the complaint and a counterclaim against us. On September 23, 2004, we filed a reply to Alcon's counterclaim.

On August 4, 2004, a complaint entitled *The City of New York v. Allergan, Inc., et al.* was filed in the United States District Court for the Southern District of New York. The complaint names us and 43 other defendants. We were served with the complaint on August 26, 2004. The complaint alleges that the defendants inflated the average wholesale price of pharmaceuticals and reported false pricing information, which increased the cost of the city's Medicaid program. The case is currently stayed pending a ruling on a motion in a related case.

On August 26, 2004, a complaint entitled *Tilley Apothecaries, et al. v. Allergan, Inc., et al.* was filed in the Superior Court of the State of California for the County of Alameda. The complaint names us and 12 other defendants. We were served with the complaint on August 30, 2004. The complaint alleges unfair business practices based upon a price fixing

Allergan, Inc.

Litigation (Continued)

conspiracy in connection with the reimportation of pharmaceuticals from Canada. On September 3, 2004, the plaintiffs filed a First Amended Complaint, making various modifications to the original complaint. A status conference is scheduled for November 10, 2004.

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

Allergan, Inc.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Issuer Purchases of Equity Securities

The following table discloses the purchases of our equity securities during the third fiscal quarter of 2004.

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs(2)
June 26, 2004 to July 31, 2004	25,000	\$89.44	25,000	6,611,298
August 1, 2004 to August 31, 2004	470,700	\$73.31	470,700	6,219,371
September 1, 2004 to September 24, 2004	0	N/A	0	6,219,371
Total	495,700	\$74.12	495,700	N/A

- (1) The Company maintains an evergreen stock repurchase program, which was first announced on September 28, 1993. Under the stock repurchase program, the Company may maintain up to 9.2 million repurchased shares in its treasury account at any one time. As of September 24, 2004, the Company held approximately 3.0 million treasury shares under this program.
- (2) The following share numbers reflect the maximum number of shares that may be purchased under the Company's stock repurchase program and are as of the end of each of the respective periods.

Item 5. Other Information.

Other Information

Effective October 27, 2004, our board of directors approved certain restructuring activities related to the scheduled termination of our manufacturing and supply agreement with Advanced Medical Optics, Inc.(AMO). Under the manufacturing and supply agreement, which was entered into in connection with the June 2002 spin-off of AMO, we agreed to manufacture certain contact lens care products and VITRAX for AMO for a period of up to three years ending on June 30, 2005. As part of the termination of the manufacturing and supply agreement, we will eliminate certain manufacturing positions at our Westport, Ireland; Waco, Texas; and Guarulhos, Brazil manufacturing facilities.

We anticipate that the additional pre-tax restructuring charges to be incurred in connection with the termination of the manufacturing and supply agreement, which are expected to total between \$24 million and \$28 million, will be recorded beginning in the fourth quarter of 2004 and continue up through and including the fourth quarter of 2005.

The pre-tax charges are net of expected tax credits available under qualifying government-sponsored employment programs. Approximately \$24 million of the additional restructuring charges are expected to be cash charges. The additional restructuring charges are expected to include approximately \$20 million to \$22 million associated with the reduction in our workforce by approximately

Allergan, Inc.

Other Information (Continued)

450 individuals. The workforce reduction will impact personnel in Europe, the United States and Latin America. The workforce reduction will begin in the fourth quarter of 2004 and is expected to be completed by the end of the second quarter 2005. The additional restructuring costs are also expected to include approximately \$4 million to \$6 million associated with asset write-offs and other costs associated with the termination of the manufacturing and supply agreement. Certain restructuring charges related to asset disposal will be recorded through the fourth quarter of 2005.

Item 6. Exhibits

Exhibits (numbered in accordance with Item 601 of Regulation S-K)

- 4.11 Amended and Restated Indenture, dated as of July 28, 2004, between the Company and Wells Fargo Bank, National Association
- 31.1 Certification of Principal Executive Officer Required Under Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 31.2 Certification of Principal Financial Officer Required Under Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 32 Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C Section 1350

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 1, 2004

ALLERGAN, INC.

/s/ Eric K. Brandt
Eric K. Brandt
Executive Vice President, Finance,
Strategy and Corporate Development
(Principal Financial Officer)

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Exhibit Index

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32	Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C Section 1350