

ALLERGAN INC  
Form 10-Q  
August 09, 2006

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**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 June 30, 2006

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 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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of August 3, 2006, there were 153,755,944 shares of common stock outstanding (including 2,959,099 shares held in treasury).

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FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2006  
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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

Allergan, Inc.

Unaudited Condensed Consolidated Statements of Operations

(in millions, except per share amounts)

	Three months ended		Six months ended	
	June 30, 2006	June 24, 2005	June 30, 2006	June 24, 2005
Revenues				
Product net sales	\$787.0	\$591.0	\$1,402.2	\$1,118.2
Other revenues	14.7	3.6	25.2	6.5
Total revenues	801.7	594.6	1,427.4	1,124.7
Operating costs and expenses				
Cost of sales	168.2	107.2	265.5	200.1
Selling, general and administrative	337.5	245.1	611.4	458.1
Research and development	140.3	90.7	809.7	172.0
Amortization of acquired intangible assets	24.8	5.1	29.9	7.2
Restructuring charges	5.7	10.3	8.5	37.7
Operating income (loss)	125.2	136.2	(297.6)	249.6
Non-operating income (expense)				
Interest income	12.3	6.1	21.5	11.6
Interest expense	(20.5)	(4.6)	(28.3)	(9.1)
Unrealized (loss) gain on derivative instruments, net	(0.2)	1.1	(1.2)	1.2
Other, net	(4.5)	(0.7)	(5.2)	3.8
	(12.9)	1.9	(13.2)	7.5
Earnings (loss) before income taxes and minority interest	112.3	138.1	(310.8)	257.1
Provision for income taxes	37.8	104.1	59.7	143.3
Minority interest expense	0.3	0.6	0.1	0.5
Net earnings (loss)	\$ 74.2	\$ 33.4	\$ (370.6)	\$ 113.3
Earnings (loss) per share:				
Basic	\$ 0.49	\$ 0.26	\$ (2.60)	\$ 0.87
Diluted	\$ 0.49	\$ 0.25	\$ (2.60)	\$ 0.86

See accompanying notes to unaudited condensed consolidated financial statements.

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

	June 30, 2006	December 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and equivalents	\$ 895.2	\$1,296.3
Trade receivables, net	356.4	246.1
Inventories	183.4	90.1
Other current assets	212.5	193.1
Total current assets	1,647.5	1,825.6
Investments and other assets	276.5	258.9
Deferred tax assets		123.2
Property, plant and equipment, net	566.1	494.0
Goodwill	1,797.0	9.0
Intangibles, net	1,092.7	139.8
Total assets	\$5,379.8	\$2,850.5
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Notes payable	\$ 59.0	\$ 169.6
Convertible notes, net of discount		520.0
Accounts payable	132.6	92.3
Accrued compensation	90.4	84.8
Other accrued expenses	231.8	177.3
Income taxes	20.3	
Total current liabilities	534.1	1,044.0
Long-term debt	855.8	57.5
Long-term convertible notes, net of discount	750.0	
Deferred tax liabilities	149.2	
Other liabilities	222.5	181.0
Commitments and contingencies		
Minority interest	1.3	1.1
Stockholders' equity:		
Preferred stock, \$.01 par value; authorized 5,000,000 shares; none issued		
Common stock, \$.01 par value; authorized 300,000,000 shares; issued 153,756,000 shares as of June 30, 2006 and 134,255,000 shares as of December 31, 2005	1.5	1.3
Additional paid-in capital	2,307.9	417.7
Accumulated other comprehensive loss	(29.7)	(50.6)
Retained earnings	901.3	1,305.1

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	3,181.0	1,673.5
Less treasury stock, at cost (3,006,000 shares as of June 30, 2006 and 1,431,000 shares as of December 31, 2005, respectively)	(314.1)	(106.6)
Total stockholders' equity	2,866.9	1,566.9
Total liabilities and stockholders' equity	\$5,379.8	\$2,850.5

See accompanying notes to unaudited condensed consolidated financial statements.

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Allergan, Inc.  
 Unaudited Condensed Consolidated Statements of Cash Flows  
 (in millions)

	Six months ended	
	June 30, 2006	June 24, 2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) earnings	\$ (370.6)	\$ 113.3
Non-cash items included in earnings:		
In-process research and development charge	579.3	
Depreciation and amortization	65.7	37.5
Amortization of original issue discount and debt issuance costs	7.6	4.9
Amortization of net realized gain on interest rate swap	(0.3)	
Deferred income taxes	(13.7)	1.0
Loss on investments and disposal of fixed assets	3.4	
Unrealized loss (gain) on derivative instruments	1.2	(1.2)
Expense of share-based compensation plans	32.0	7.1
Minority interest expense	0.1	0.3
Restructuring charge	8.5	37.7
Changes in assets and liabilities:		
Trade receivables	(32.3)	(43.8)
Inventories	16.9	1.9
Other current assets	4.4	(6.6)
Other non-current assets	(1.0)	3.5
Accounts payable	8.4	21.4
Accrued expenses	(10.0)	(26.3)
Income taxes	4.5	57.7
Other liabilities	18.2	7.1
Net cash provided by operating activities	322.3	215.5
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of Inamed, net of cash acquired	(1,328.3)	
Additions to property, plant and equipment	(49.3)	(20.4)
Additions to capitalized software	(9.0)	(6.9)
Additions to intangible assets	(11.0)	(99.3)
Proceeds from sale of investments	0.3	
Proceeds from sale of property, plant and equipment	3.2	1.3
Other, net		0.2
Net cash used in investing activities	(1,394.1)	(125.1)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Dividends to stockholders	(28.3)	(26.1)
Proceeds from issuance of senior notes	797.7	
Proceeds from issuance of convertible senior notes	750.0	



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Debt issuance costs	(19.3)	
Bridge credit facility borrowings	825.0	
Bridge credit facility repayments	(825.0)	
Repayments of convertible borrowings	(521.9)	
Net repayments of notes payable	(110.5)	(8.6)
Sale of stock to employees	79.0	16.0
Payments to acquire treasury stock	(307.8)	(94.3)
Net proceeds from settlement of interest rate swap	13.0	
Excess tax benefits from share-based compensation	15.0	
Net cash provided by (used in) financing activities	666.9	(113.0)
Effect of exchange rate changes on cash and equivalents	3.8	0.9
Net decrease in cash and equivalents	(401.1)	(21.7)
Cash and equivalents at beginning of period	1,296.3	894.8
Cash and equivalents at end of period	\$ 895.2	\$ 873.1
Supplemental disclosure of cash flow information		
Cash paid for:		
Interest (net of capitalization)	\$ 9.4	\$ 5.1
Income taxes, net of refunds	\$ 73.4	\$ 86.1

On March 23, 2006, the Company completed the acquisition of Inamed Corporation. In exchange for the common stock of Inamed Corporation, the Company issued common stock with a fair value of \$1,859.3 million and paid \$1,328.3 million in cash, net of cash acquired. In connection with the acquisition, the Company acquired assets with a fair value of \$3,759.6 million and assumed liabilities of \$469.3 million.

See accompanying notes to unaudited condensed consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements

## 1. Basis of Presentation

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, 2005. 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 six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006 or any other period(s).

**Reclassifications**

Certain reclassifications of prior year amounts have been made to conform with the current year presentation. Beginning with the second fiscal quarter of 2006, the Company reports amortization of acquired intangible assets on a separate line in its statements of operations, which includes the amortization of the intangible assets acquired in connection with the Inamed acquisition, as well as the amortization of other intangible assets previously reported in cost of sales, selling, general and administrative expenses, and research and development expenses. For the three month period ended June 24, 2005, a total of \$5.1 million of intangible asset amortization was reclassified, consisting of \$4.5 million previously classified in cost of sales and \$0.6 million previously classified in research and development expenses. For the six month period ended June 24, 2005, a total of \$7.2 million of intangible asset amortization was reclassified, consisting of \$5.7 million previously classified in cost of sales, \$0.2 million previously classified in selling, general and administrative expenses, and \$1.3 million previously classified in research and development expenses. Intangible asset amortization for the six month period ended June 30, 2006 includes a total reclassification of \$5.1 million, representing the reclassification of \$4.3 million, \$0.1 million and \$0.7 million from cost of sales, selling, general and administrative expenses, and research and development expenses, respectively, previously reported for the three month period ended March 31, 2006.

**Share-Based Payments**

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised), *Share-Based Payment* (SFAS No. 123R), which requires measurement and recognition of compensation expense for all share-based payment awards made to employees and directors. Under SFAS No. 123R, the fair value of share-based payment awards is estimated at grant date using an option pricing model and the portion that is ultimately expected to vest is recognized as compensation cost over the requisite service period. Prior to the adoption of SFAS No. 123R, the Company accounted for share-based awards using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). Under the intrinsic value method, no share-based compensation cost was recognized for awards to employees or directors if the exercise price of the award was equal to the fair market value of the underlying stock on the date of grant.

The Company adopted SFAS No. 123R using the modified prospective application method. Under the modified prospective application method, prior periods are not revised for comparative purposes. The valuation provisions of SFAS No. 123R apply to new awards and awards that are outstanding on the adoption effective date that are subsequently modified or cancelled. Estimated compensation expense for awards outstanding and unvested on the adoption effective date is recognized over the remaining service period using the compensation cost calculated for *pro forma* disclosure purposes under SFAS No. 123.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Pre-tax share-based compensation expense recognized under SFAS No. 123R for the three month period ended June 30, 2006 was \$16.6 million, which consisted of compensation related to employee and director stock options of \$11.3 million, employee and director restricted share awards of \$3.0 million and \$2.3 million related to stock contributed to employee benefit plans. Pre-tax share-based compensation expense recognized under SFAS No. 123R for the six month period ended June 30, 2006 was \$31.9 million, which consisted of compensation related to employee and director stock options of \$21.4 million, employee and director restricted share awards of \$4.8 million and \$5.7 million related to stock contributed to employee benefit plans. Pre-tax share-based compensation expense recognized under APB No. 25 for the three month period ended June 24, 2005 was \$3.4 million, which consisted of compensation related to employee and director restricted share awards of \$1.3 million and \$2.1 million related to stock contributed to employee benefit plans. Pre-tax share-based compensation expense recognized under APB No. 25 for the six month period ended June 24, 2005 was \$7.0 million, which consisted of compensation related to employee and director restricted share awards of \$2.2 million and \$4.8 million related to stock contributed to employee benefit plans. There was no share-based compensation expense recognized during the three and six month periods ended June 24, 2005 related to employee or director stock options. The income tax benefit related to recognized share-based compensation was \$6.0 million and \$11.5 million for the three and six month periods ended June 30, 2006, respectively. The income tax benefit related to recognized share-based compensation was \$1.2 million and \$2.5 million for the three and six month periods ended June 24, 2005, respectively.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of share-based awards. The determination of fair value using the Black-Scholes model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company's expected stock price volatility over the term of the awards and projected employee stock option exercise behaviors. Prior to the adoption of SFAS No. 123R the Company used an estimated stock price volatility based on the Company's five year historical average. Upon adoption of SFAS No. 123R the Company changed its estimated volatility calculation to an equal weighting of the Company's ten year historical average and the average implied volatility of at-the-money options traded in the open market. The Company believes this method provides a more accurate estimate of stock price volatility over the expected life of the share-based awards. Employee stock option exercise behavior is estimated based on actual historical exercise activity and assumptions regarding future exercise activity of unexercised, outstanding options.

The Company recognizes share-based compensation cost over the requisite service period using the straight-line single option method. Since share-based compensation under SFAS No. 123R is recognized only for those awards that are ultimately expected to vest, an estimated forfeiture rate has been applied to unvested awards for the purpose of calculating compensation cost. SFAS No. 123R requires these estimates to be revised, if necessary, in future periods if actual forfeitures differ from the estimates. Changes in forfeiture estimates impact compensation cost in the period in which the change in estimate occurs. In the Company's *pro forma* information required under SFAS No. 123 prior to January 1, 2006, the Company accounted for forfeitures as they occurred.

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3, *Transitional Election Related to Accounting for Tax Effects of Share-Based Payment Awards*. The Company has elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS No. 123R. The alternative transition method includes a simplified method to establish the beginning balance additional paid-in capital pool (APIC Pool) related to tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123R.

**Recently Adopted Accounting Standards**

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154). SFAS No. 154 requires retrospective application to prior-period financial statements of changes in accounting principles, unless a new accounting pronouncement provides specific transition provisions to the contrary or it is impracticable to determine either the period-specific effects or the cumulative effect

of the change. SFAS No. 154 also redefines restatement as the revising of previously issued financial statements to reflect the correction of an error. The Company adopted the provision of SFAS No. 154 in its first fiscal quarter of 2006. The adoption did not have a material effect on the Company's consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

***New Accounting Standards Not Yet Adopted***

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140* (SFAS No. 155). SFAS No. 155 permits an entity to measure at fair value any financial instrument that contains an embedded derivative that otherwise would require bifurcation. This statement is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006, which is the Company's fiscal year 2007. The Company does not expect the adoption of SFAS No. 155 to have a material impact on its consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 will be effective for fiscal years beginning after December 15, 2006, which is the Company's fiscal year 2007. The Company has not yet evaluated the potential impact of adopting FIN 48 on its consolidated financial statements.

**2. Inamed Acquisition**

On March 23, 2006, the Company completed the acquisition of Inamed Corporation (Inamed), a global healthcare company that develops, manufactures, and markets a diverse line of products, including breast implants, a range of dermal products to correct facial wrinkles and products for the treatment of obesity.

The Inamed acquisition was completed pursuant to an agreement and plan of merger, dated as of December 20, 2005, and subsequently amended as of March 11, 2006, by and among the Company, its wholly-owned subsidiary Banner Acquisition, Inc., and Inamed and an exchange offer made by Banner Acquisition to acquire Inamed shares for either \$84.00 in cash or 0.8498 of a share of the Company's common stock, subject to proration so that 45% of the aggregate Inamed shares tendered were exchanged for cash and 55% of the aggregate Inamed shares tendered were exchanged for shares of the Company's common stock. In the exchange offer the Company paid approximately \$1.31 billion in cash and issued 16,194,051 shares of common stock through Banner Acquisition, acquiring approximately 93.86% of Inamed's outstanding common stock. Following the exchange offer, the remaining outstanding shares of Inamed common stock were acquired for approximately \$81.7 million in cash and 1,010,576 shares of Allergan common stock through the merger of Banner Acquisition with and into Inamed in a merger in which Inamed survived as Allergan's wholly-owned subsidiary. As a final step in the plan of reorganization, the Company merged Inamed into Inamed, LLC, a wholly-owned subsidiary of the Company. The consideration paid in the merger does not include shares of the Company's common stock and cash that were paid to former Inamed option holders for outstanding options to purchase shares of Inamed common stock, which were cancelled in the merger and converted into the right to receive an amount of cash equal to 45% of the in the money value of the option and a number of shares of the Company's common stock with a value equal to 55% of the in the money value of the option. Subsequent to the merger, the Company issued 237,066 shares of common stock and paid \$17.9 million in cash to satisfy its obligation to the option holders. The fair value of these shares of Company common stock and cash paid to option holders of Inamed common stock were included in the calculation of the purchase price detailed below.

The following table summarizes the components of the Inamed purchase price:

	(in millions)
Fair value of Allergan shares issued	\$1,859.3
Cash consideration	1,409.3
Transaction costs	21.7
	\$3,290.3

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The value of the shares of Company common stock used in determining the purchase price was \$106.60 per share, based on the closing price of the Company's common stock on December 20, 2005, the effective date of the merger agreement.

**Purchase Price Allocation**

The Inamed purchase price was allocated to tangible and intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date (March 23, 2006). The excess of the purchase price over the fair value of net assets acquired was allocated to goodwill. The Company expects that all such goodwill will not be deductible for tax purposes.

The Company believes the fair values assigned to the assets acquired and liabilities assumed were based on reasonable assumptions. The following table summarizes the estimated fair values of net assets acquired:

	(in millions)
Current assets	\$ 310.1
Property, plant & equipment	64.7
Identifiable intangible assets	971.9
In-process research and development	579.3
Goodwill	1,787.7
Other non-current assets, primarily deferred tax assets	45.9
Accounts payable and accrued liabilities (a)	(109.2)
Deferred tax liabilities – current and non-current	(336.3)
Other non-current liabilities	(23.8)
	\$3,290.3

- (a) Accounts payable and accrued liabilities include approximately \$9.7 million of recognized liabilities related to the involuntary termination and relocation of certain Inamed employees in accordance with the Emerging Issues Task Force (EITF) in EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* (EITF 95-3).

The Company's fair value estimates for the purchase price allocation may change during the allowable allocation period, which is up to one year from the acquisition date, if additional information becomes available.

**In-process Research and Development**

In conjunction with the Inamed acquisition, the Company recorded a charge to in-process research and development expense of \$579.3 million for acquired in-process research and development assets that the Company determined were not yet complete and had no alternative future uses in their current state. In the second quarter of 2006, the Company adjusted its estimate of the value of acquired in-process research and development expense by \$16.5 million from the original estimate of \$562.8 million recorded in the first quarter of 2006. These assets are composed of Inamed's silicone breast implant technology for use in the United States, Inamed's Juvéderm dermal filler technology for use in the United States, and Inamed's BioEnterics IntraGastric Balloon (BIB) technology for use in the United States, which were all subject to approval by the FDA in the United States on the Inamed acquisition date.

The estimated fair value of the in-process research and development assets was determined based on the use of a discounted cash flow model using an income approach for the acquired technologies. Estimated revenues were probability adjusted to take into account the stage of completion and the risks surrounding the successful development and commercialization. The estimated after-tax cash flows were then discounted to a present value using discount rates ranging from 12% to 15%. Material net cash inflows were estimated to begin in 2006 for the silicone breast implants and Juvéderm and in 2008 for the BIB system. Gross margin and expense levels were estimated to be consistent with Inamed's historical results.



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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The major risks and uncertainties associated with the timely and successful completion of the acquired in-process projects consist of the ability to confirm the safety and efficacy of the technology based on the data from clinical trials and obtaining necessary regulatory approvals. The major risks and uncertainties associated with the core technology consist of the Company's ability to successfully utilize the technology in future research projects. No assurance can be given that the underlying assumptions used to forecast the cash flows or the timely and successful completion of the projects will materialize, as estimated. For these reasons, among others, actual results may vary significantly from estimated results.

**Identifiable Intangible Assets**

Acquired identifiable intangible assets include product rights for approved indications of currently marketed products, customer relationships, trademarks and core technology for saline-filled and silicone-filled breast implants, dermal fillers, and obesity intervention products. The amounts assigned to each class of intangible assets and the related weighted average amortization periods are summarized in the following table:

	Value of intangible assets acquired (in millions)	Weighted-average amortization period
Developed technology	\$ 796.4	15.4 years
Core technology	113.3	16.0 years
Customer relationships	42.3	3.1 years
Trademarks	19.9	5.0 years
Total	\$ 971.9	

**Pro Forma Results of Operations**

Unaudited *pro forma* operating results for the Company, assuming the acquisition of Inamed occurred January 1, 2006 and 2005 and excluding any *pro forma* charge for in-process research and development costs, inventory fair value adjustments and Inamed share-based compensation expense in 2006 and transaction costs are as follows:

(in millions, except per share amounts)	Three months ended		Six months ended	
	June 30, 2006	June 24, 2005	June 30, 2006	June 24, 2005
	<b>(in millions, except per share amounts)</b>			
Product net sales	\$787.0	\$705.6	\$1,501.6	\$1,338.1
Total revenues	\$801.7	\$709.2	\$1,526.8	\$1,344.6
Net earnings	\$108.0	\$ 32.1	\$ 211.3	\$ 102.8
Basic earnings per share	\$ 0.72	\$ 0.22	\$ 1.40	\$ 0.69
Diluted earnings per share	\$ 0.71	\$ 0.21	\$ 1.37	\$ 0.69

The *pro forma* information is not necessarily indicative of the actual results that would have been achieved had the acquisition occurred as of January 1, 2006 and 2005, or the results that may be achieved in the future.

**3. Restructuring Charges, Integration Costs and Transition/Duplicate Operating Expenses****Restructuring and Integration of Inamed Operations**

In connection with the March 2006 Inamed acquisition, the Company initiated a global restructuring and integration plan to merge Inamed's operations with the Company's operations and to capture synergies through the centralization of certain general and administrative and commercial functions. Specifically, the restructuring and



integration activities involve eliminating certain general and administrative positions, moving key commercial Inamed functions to the Company's locations around the world, integrating Inamed's distributor operations with the Company's existing distribution network and integrating Inamed's information systems with the Company's information systems.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The Company has incurred, and anticipates that it will continue to incur, restructuring charges and charges relating to severance, relocation and one-time termination benefits, payments to public employment and training programs, integration and transition costs, and contract termination costs in connection with the Inamed restructuring. The Company currently estimates that the total pre-tax charges resulting from the restructuring, including integration and transition costs, will be between \$63.0 million and \$78.0 million, all of which are expected to be cash expenditures. In addition to the pre-tax charges, the Company expects to incur capital expenditures of approximately \$20.0 million to \$25.0 million, primarily related to the integration of information systems.

The foregoing estimates are based on assumptions relating to, among other things, a reduction of approximately 53 positions, principally general and administrative positions at Inamed locations. These workforce reduction activities began in the second quarter of 2006 and are expected to be substantially completed by the close of the fourth quarter of 2007. Charges associated with the workforce reduction, including severance, relocation and one-time termination benefits, and payments to public employment and training programs, are currently expected to total approximately \$7.0 million to \$9.0 million.

Estimated charges include estimates for contract and lease termination costs, including the termination of duplicative distributor arrangements. The Company began to record these costs in the second quarter of 2006 and expects to continue to incur them up through and including the fourth quarter of 2007.

The Company also expects to pay an additional amount of approximately \$10.0 million to \$25.0 million for taxes related to intercompany transfers of trade businesses and net assets, which will be capitalized and amortized over the expected lives of the underlying assets.

As of June 30, 2006, the Company has recorded cumulative pre-tax restructuring charges of \$1.7 million, primarily consisting of employee severance, one-time termination benefits, employee relocation and other costs, related to the restructuring of the Inamed operations.

During the first six months of 2006, the Company also recorded \$10.4 million of integration and transition costs associated with the Inamed integration. Integration and transition costs consisted primarily of salaries, travel, communications, recruitment and consulting costs. Integration and transition costs for the six month period ended June 30, 2006 consisted of \$0.5 million in cost of sales, \$9.7 million in selling, general and administrative expenses and \$0.2 million in research and development expenses.

***Restructuring and Streamlining of Operations in Japan***

On September 30, 2005, the Company entered into a long-term agreement with GlaxoSmithKline (GSK) to develop and promote the Company's *Botox* product in Japan and China. Under the terms of this agreement, the Company licensed to GSK all clinical development and commercial rights to *Botox* in Japan and China. As a result of this agreement, the Company initiated a plan in October 2005 to restructure and streamline its operations in Japan. As of June 30, 2006, the Company substantially completed the restructuring activities and recorded cumulative pre-tax restructuring charges of \$1.9 million (\$2.3 million in 2005 and a net reversal of \$0.4 million in 2006).

***Restructuring and Streamlining of European Operations***

Effective January 2005, the Company's Board of Directors approved the initiation and implementation of a restructuring of certain activities related to the Company's European operations to optimize operations, improve resource allocation and create a scalable, lower cost and more efficient operating model for the Company's European research and development (R&D) and commercial activities. Specifically, the restructuring involved moving key European R&D and select commercial functions from the Company's Mougins, France and other European locations to the Company's Irvine, California, Marlow, United Kingdom and Dublin, Ireland facilities and

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streamlining functions in the Company's European management services group. The workforce reduction began in the first quarter of 2005 and was substantially completed by the close of the second quarter of 2006.

As of June 30, 2006, the cumulative European restructuring charges were \$35.0 million, primarily related to severance, relocation and one-time termination benefits, payments to public employment and training programs, contract termination costs and capital and other asset-related expenses. Additionally, the Company has incurred cumulative transition/duplicate operating expenses of \$11.5 million as of June 30, 2006. Transition expenses relate primarily to legal, consulting, recruiting, information system implementation costs and taxes related to the European restructuring activities. Duplicate operating expenses are costs incurred during the transition period to ensure that job knowledge and skills are properly transferred to new employees. The Company expects to record an additional \$1.0 million to \$4.0 million in pre-tax restructuring charges and less than \$1.0 million of transition/duplicate operating expenses over the remaining transition period, which are expected to be completed by the end of the third fiscal quarter of 2006.

During the three and six month periods ended June 30, 2006, the Company recorded \$3.2 million and \$6.1 million, respectively of restructuring charges related to the European operations. For the three month period ended June 30, 2006, the Company recorded \$0.6 million of transition/duplicate operating expenses, consisting of \$0.4 million in selling, general and administrative expenses and \$0.2 million in research and development expenses. For the six month period ended June 30, 2006, the Company recorded \$2.5 million of transition/duplicate operating expenses, consisting of \$2.1 million in selling, general and administrative expenses and \$0.4 million in research and development expenses. Additionally, during the six month period ended June 30, 2006, the Company recorded a \$3.4 million loss related to the sale of its Mougins, France facility, which was included in selling, general and administrative expenses.

The following table presents the cumulative restructuring activities related to the Company's European operations through June 30, 2006:

	<b>Employee Severance</b>	<b>Other Costs (in millions)</b>	<b>Total</b>
Net charge during 2005	\$ 25.9	\$ 3.0	\$ 28.9
Assets written off		(0.2)	(0.2)
Spending	(10.7)	(2.8)	(13.5)
Balance at December 31, 2005	15.2		15.2
Net charge during the six month period ended June 30, 2006	2.3	3.8	6.1
Spending	(8.5)	(0.4)	(8.9)
Balance at June 30, 2006 (included in Other accrued expenses for employee severance and in Other liabilities for other costs)	\$ 9.0	\$ 3.4	\$ 12.4

***Termination of Manufacturing and Supply Agreement with Advanced Medical Optics***

In October 2004, the Company's Board of Directors approved certain restructuring activities related to the scheduled termination in June 2005 of the Company's manufacturing and supply agreement with Advanced Medical Optics (AMO), which the Company spun-off in June 2002. Under the manufacturing and supply agreement, which was entered into in connection with the AMO spin-off, the Company agreed to manufacture certain contact lens care products and VITRAX, a surgical viscoelastic, for AMO for a period of up to three years ending in June 2005. As part of the scheduled termination of the manufacturing and supply agreement, the Company eliminated certain manufacturing positions at the Company's Westport, Ireland; Waco, Texas; and Guarulhos, Brazil manufacturing

facilities.

As of June 30, 2006, the Company had substantially completed all activities related to the termination of the manufacturing and supply agreement and recorded cumulative pre-tax restructuring charges of \$22.7 million (\$7.1 million in 2004, \$14.5 million in 2005 and \$1.1 million in 2006). The Company expects to record additional pre-tax

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

restructuring charges of less than \$1.0 million in the aggregate during the third and fourth quarters of 2006 to complete the refurbishment of facilities previously used for contract manufacturing.

## 4. Intangibles and Goodwill

At June 30, 2006 and December 31, 2005, the components of amortizable and unamortizable intangibles and goodwill and certain other related information were as follows:

***Intangibles***

	June 30, 2006			December 31, 2005		
	Gross Amount (in millions)	Accumulated Amortization	Weighted Average Amortization Period (in years)	Gross Amount (in millions)	Accumulated Amortization	Weighted Average Amortization Period (in years)
<b>Amortizable Intangible Assets:</b>						
Developed technology	\$ 796.4	\$ (13.3)	15.4	\$	\$	
Customer relationships	42.3	(3.4)	3.1			
Licensing	148.8	(34.8)	8.0	137.8	(25.5)	8.0
Trademarks	23.3	(3.4)	6.5	3.5	(2.3)	15.0
Core technology	142.6	(6.8)	15.8	29.3	(4.1)	15.0
Other	1.1	(1.0)	5.0	1.1	(0.9)	5.0
	1,154.5	(62.7)	13.9	171.7	(32.8)	9.3
<b>Unamortizable Intangible Assets:</b>						
Business licenses	0.9			0.9		
	\$1,155.4	\$ (62.7)		\$172.6	\$ (32.8)	

Developed technology consists primarily of current product offerings, primarily saline and silicone breast implants, obesity intervention products and dermal fillers acquired in connection with the Inamed acquisition. Customer relationship assets consist of the estimated value of relationships with customers acquired in connection with the Inamed acquisition, primarily in the breast implant market in the United States. 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. Core technology consists of proprietary technology associated with silicone breast implants and intragastric balloon systems acquired in connection with the Inamed acquisition, and a drug delivery technology acquired in connection with the 2003 Oculex acquisition. The increase in developed technology, customer relationships, trademarks and core technology at June 30, 2006 compared to December 31, 2005 was primarily due to the Inamed acquisition. The increase in licensing assets is primarily due to milestone payments related to the approvals of Juvéderm in the United States and Australia, which were received in the second quarter of 2006.

Aggregate amortization expense for amortizable intangible assets was \$24.8 million and \$5.1 million for the quarters ended June 30, 2006 and June 24, 2005, respectively, and \$29.9 million and \$7.2 million for the six month periods ended June 30, 2006 and June 24, 2005, respectively.

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Estimated amortization expense is \$79.5 million for 2006, \$98.6 million for 2007, \$96.8 million for 2008, \$86.7 million for 2009, \$82.3 million for 2010 and \$79.0 million for 2011.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

**Goodwill**

<u>(in millions)</u>	June 30, 2006	December 31, 2005
Goodwill:		
United States	\$1,792.3	\$ 4.6
Latin America	3.9	3.6
Europe and Other	0.8	0.8
	\$1,797.0	\$ 9.0

The increase in goodwill at June 30, 2006 compared to December 31, 2005 was primarily due to the Inamed acquisition. Goodwill related to the Inamed acquisition is reflected in the United States balance above. The Company's management has not completed its analysis of goodwill. Once the analysis is complete, goodwill will be reflected in the geographical locations to which it relates.

## 5. Inventories

Components of inventories were:

<u>(in millions)</u>	June 30, 2006	December 31, 2005
Finished goods	\$119.3	\$ 52.9
Work in process	34.7	24.8
Raw materials	29.4	12.4
Total	\$183.4	\$ 90.1

The increase in inventories at June 30, 2006 compared to December 31, 2005 was primarily due to the Inamed acquisition. At June 30, 2006, approximately \$6.9 million of Allergan's finished goods medical device inventories, primarily breast implants, were held on consignment at a large number of doctors' offices, clinics, and hospitals worldwide. The value and quantity at any one location is not significant.

## 6. 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's effective tax rate may be subject to fluctuations during the fiscal year as new information is obtained, which may affect the assumptions management uses to estimate the annual effective tax rate, including factors such as mix of pre-tax earnings in the various tax jurisdictions in which it operates, 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 the Company conducts operations. The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its 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 deferred tax assets, its income tax expense will increase or decrease, respectively, in the period such determination is made.

Valuation allowances against deferred tax assets were \$43.1 million and \$44.1 million at June 30, 2006 and December 31, 2005, respectively. Changes in the valuation allowances are generally a component of the estimated annual effective tax rate. The decrease in the amount of valuation allowances at June 30, 2006 compared to December 31, 2005 is primarily due to a decrease in the valuation allowance related to deferred tax assets for certain capitalized intangible assets that became realizable due to the completion of a federal tax audit in the United States. This decrease in the amount of the valuation allowance was partially offset by an increase in valuation allowances



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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

due to the Inamed acquisition. 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 the Company.

The Company has not provided for withholding and U.S. taxes for the unremitted earnings of certain non-U.S. subsidiaries because it has currently reinvested these earnings indefinitely in the operations of these non-U.S. subsidiaries. At December 31, 2005, the Company had approximately \$299.5 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, if any. The Company annually updates its estimate of unremitted earnings outside the United States after the completion of each fiscal year.

Included in the provision for income taxes in the first six months of 2006 is a \$14.5 million reduction in estimated income taxes payable primarily due to the resolution of several significant and previously uncertain income tax audit issues associated with the completion of an audit by the U.S. Internal Revenue Service for tax years 2000 to 2002, and a \$1.2 million beneficial change in estimate for the expected income tax benefit for previously paid state income taxes, which became recoverable due to a favorable state court decision that became final during 2004.

## 7. Employee Stock Plans

***Premium Priced Stock Option Plan***

The Company has a premium priced stock option plan that provides for the granting of non-qualified premium priced stock options to officers and key employees. On July 30, 2001, the Company granted non-qualified stock options to purchase up to 2,500,000 shares of its common stock with a weighted average exercise price of \$107.44 per share and a weighted average fair value of \$17.02 per share to participants, including the Company's executive officers, under the premium priced stock option plan. The options were issued in three tranches:

The first tranche has an exercise price equal to \$88.55;

The second tranche has an exercise price equal to \$106.26; and

The third tranche has an exercise price equal to \$127.51.

The 2001 Premium Priced Stock Option Plan provided that each tranche of options would vest and become exercisable upon the earlier of (i) the date on which the fair value of a share of the Company's common stock equals or exceeds the applicable exercise price or (ii) five years from the grant date (July 30, 2006). The options expire six years from the grant date (July 30, 2007). The first tranche of the options vested and became exercisable on March 1, 2004 as a result of the fair value of the Company's common stock exceeding \$88.55.

In response to SFAS No. 123R, on April 25, 2005, the Organization and Compensation Committee of the Company's Board of Directors approved an acceleration of the vesting of the options issued under the Allergan, Inc. 2001 Premium Priced Stock Option Plan that are held by the Company's current employees, including the Company's executive officers, and certain former employees of the Company who received grants while employees prior to the June 2002 AMO spin-off. As a result of the acceleration, the second tranche and third tranche of each option became immediately vested and exercisable effective as of May 10, 2005. Unlike typical stock options that vest over a predetermined period, the options, pursuant to their original terms, automatically vest as soon as they are in the money. Consequently, as soon as the options have any value to the participant, they would vest according to their original terms. Therefore, early vesting does not provide any immediate benefit to participants, including the Company's executive officers.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

The acceleration of the options eliminated future compensation expense that the Company would otherwise recognize in its income statement with respect to the vesting of such options following the effectiveness of SFAS No. 123R. The future expense that was eliminated was approximately \$1.0 million, net of tax (of which approximately \$0.1 million, net of tax, was attributable to options held by executive officers). This amount, plus an additional \$0.8 million, net of tax, representing the total *pro forma* amount for the combined third and fourth fiscal quarters of 2005 that otherwise would have been included in those quarters' *pro forma* earnings disclosures, was reflected in the Company's *pro forma* footnote disclosure for the three and six month periods ended June 24, 2005. This treatment is permitted under the transition guidance provided by SFAS No. 123R.

***Incentive Compensation Plan***

The Company has an incentive compensation plan that provides for the granting of non-qualified stock options, incentive stock options, stock appreciation rights, performance shares, restricted stock and restricted stock units to officers and key employees. Options granted under this incentive compensation plan are granted at an exercise price equal to the fair market value at the date of grant, have historically become vested and exercisable at a rate of 25% per year beginning twelve months after the date of grant, generally expire ten years after their original date of grant, and provide that an employee holding a stock option may exchange stock that the employee has owned for at least six months as payment against the exercise of their option. These provisions apply to all options outstanding at June 30, 2006.

Restricted share awards under the incentive compensation plan are subject to restrictions as to sale or other disposition of the shares and to restrictions that require continuous employment with the Company. The restrictions generally expire, and the awards become fully vested, four years from the date of grant; provided, however, restrictions on share awards made pursuant to the Company's management bonus plan expire and the awards become fully vested, two years from the date of grant.

***Non-employee Director Equity Incentive Plan***

The Company has a non-employee director equity incentive plan that provides for the issuance of restricted stock and non-qualified stock options to non-employee directors. Under the terms of the non-employee director equity incentive plan, each eligible non-employee director receives, upon election, reelection or appointment to the Board of Directors, an award consisting of 1,800 shares of restricted stock multiplied by the number of years, including treating any partial year as a full year, in that non-employee director's remaining term of service on the Board of Directors. In addition, each eligible non-employee director is granted a non-qualified stock option to purchase 4,500 shares of stock on the date of each regular annual meeting of stockholders at which the directors are to be elected. From 2003 to 2005, eligible non-employee directors were granted a non-qualified stock option to purchase 2,500 shares of stock on the date of each regular annual meeting of stockholders under a prior amendment to the director equity incentive plan.

Non-qualified stock options are granted at an exercise price equal to the fair market value at the date of grant, become fully vested and exercisable one year from the date of grant and expire 10 years after the date of grant. Restrictions on restricted stock awards generally expire when the awards vest. Vesting occurs at the rate of 33½% per year beginning twelve months after the date of grant.

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Stock option activity under the Company's premium priced stock option plan, incentive compensation plan and non-employee director equity incentive plan is summarized below:

	<b>Number Of Shares (in thousands)</b>	<b>Weighted Average Exercise Price</b>
Outstanding at December 31, 2005	10,782	\$ 72.86
Options granted	2,161	110.94
Options exercised	(1,198)	66.43
Options cancelled	(167)	87.86
Outstanding at June 30, 2006	11,578	80.40
Exercisable at June 30, 2006	6,798	73.38

The total pre-tax intrinsic value of options exercised during the six months ended June 30, 2006 was \$49.6 million. Upon exercise, the Company generally issues shares from treasury.

The following table summarizes stock options outstanding at June 30, 2006:

<b>Range of Exercise Prices</b>	<b>Options Outstanding</b>				<b>Options Exercisable</b>		
	<b>Number Outstanding at 6/30/06 (in thousands)</b>	<b>Average Remaining Contractual Life (in years)</b>	<b>Weighted Average Exercise Price</b>	<b>Aggregate Intrinsic Value (in millions)</b>	<b>Number Exercisable at 6/30/06 (in thousands)</b>	<b>Weighted Average Exercise Price</b>	<b>Aggregate Intrinsic Value (in millions)</b>
\$ 12.75 - \$ 51.00	754	2.4	\$ 29.82	\$ 58.4	754	\$ 29.82	\$ 58.4
\$ 51.01 - \$ 63.76	1,854	5.5	57.75	91.8	1,428	57.05	71.7
\$ 63.77 - \$ 76.51	2,936	7.2	69.50	110.8	1,603	67.05	64.5
\$ 76.52 - \$ 89.26	2,724	5.8	82.50	67.5	1,857	82.28	46.4
\$ 89.27 - \$114.76	2,735	7.9	109.43		583	105.20	1.2
\$114.77 - \$127.51	575	1.1	127.48		573	127.51	

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value based on the Company's closing stock price of \$107.26 as of June 30, 2006, which would have been received by the option holders had all the option holders exercised their options as of that date.

The fair value of restricted shares is based on the market value of the Company's shares on the date of grant. The following table summarizes the Company's restricted share activity for the six month period ended June 30, 2006:

	<b>Number Of Shares (in thousands)</b>	<b>Weighted Average Grant-Date Fair Value</b>
Restricted share awards at December 31, 2005	189	\$ 74.23
Shares granted	105	97.39

Shares vested	(24)	105.71
Shares cancelled	(6)	92.56
Restricted share awards at June 30, 2006	264	86.10

***Valuation and Expense Recognition of Share-Based Awards***

On January 1, 2006, the Company adopted SFAS No. 123R, which requires the measurement and recognition of compensation expense for all share-based awards made to the Company's employees and directors based on the estimated fair value of the awards. The Company adopted SFAS No. 123R using the modified prospective application method, under which prior periods are not retrospectively revised for comparative purposes. Accordingly, no compensation expense for stock options was recognized for the periods prior to January 1, 2006.

Pre-tax share-based compensation expense recognized under SFAS No. 123R for the three month period ended June 30, 2006 was \$16.6 million, which consisted of compensation related to employee and director stock options of \$11.3 million, employee and director restricted share awards of \$3.0 million and \$2.3 million related to stock

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

contributed to employee benefit plans. Pre-tax share-based compensation expense recognized under SFAS No. 123R for the six month period ended June 30, 2006 was \$31.9 million, which consisted of compensation related to employee and director stock options of \$21.4 million, employee and director restricted share awards of \$4.8 million and \$5.7 million related to stock contributed to employee benefit plans. Pre-tax share-based compensation expense recognized under APB No. 25 for the three month period ended June 24, 2005 was \$3.4 million, which consisted of compensation related to employee and director restricted share awards of \$1.3 million and \$2.1 million related to stock contributed to employee benefit plans. Pre-tax share-based compensation expense recognized under APB No. 25 for the six month period ended June 24, 2005 was \$7.0 million, which consisted of compensation related to employee and director restricted share awards of \$2.2 million and \$4.8 million related to stock contributed to employee benefit plans. There was no share-based compensation expense recognized during the three and six month periods ended June 24, 2005 related to employee or director stock options. The income tax benefit related to recognized share-based compensation was \$6.0 million and \$11.5 million for the three and six month periods ended June 30, 2006, respectively. The income tax benefit related to recognized share-based compensation was \$1.2 million and \$2.5 million for the three and six month periods ended June 24, 2005, respectively.

The following table summarizes pre-tax share-based compensation recognized for stock option awards for the three and six month periods ended June 30, 2006 and June 24, 2005, respectively.

	Three months ended		Six months ended	
	June 30, 2006	June 24, 2005	June 30, 2006	June 24, 2005
	(in millions)		(in millions)	
Cost of sales	\$0.7	\$	\$ 1.4	\$
Selling, general and administrative expense	7.8		14.8	
Research and development	2.8		5.2	

The Company uses the Black-Scholes option-pricing model to estimate the fair value of share-based awards. The determination of fair value using the Black-Scholes option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables including expected stock price volatility, risk-free interest rate, expected dividends and projected employee stock option exercise behaviors. The weighted average estimated fair value of employee and director stock options granted during the six month period ended June 30, 2006 was \$35.65 per share using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Six months ended June 30, 2006
Expected volatility	30.04%
Risk-free interest rate	4.47%
Expected dividend yield	0.50%
Expected option life (in years)	4.75

Upon adoption of SFAS No. 123R the Company changed its estimated volatility calculation to an equal weighting of the Company's ten year historical average and the average implied volatility of at-the-money options traded in the open market. Prior to the adoption of SFAS No. 123R, the Company used an estimated stock price volatility based on the Company's five year historical average. The Company believes the current method provides a more accurate estimate of stock price volatility over the expected life of the share-based awards.

The risk-free interest rate assumption is based on observed interest rates for the appropriate term of the Company's stock options. The Company does not target a specific dividend yield for its dividend payments but is

required to assume a dividend yield as an input to the Black-Scholes option-pricing model. The dividend yield assumption is based on the Company's history and an expectation of future dividend amounts. The expected option life assumption is estimated based on actual historical exercise activity and assumptions regarding future exercise activity of unexercised, outstanding options.

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Share-based compensation expense under SFAS No. 123R is recognized only for those awards that are ultimately expected to vest. An estimated annual forfeiture rate of 4.2% has been applied to unvested awards for the purpose of calculating compensation cost. Forfeitures were estimated based on historical experience. SFAS No. 123R requires these estimates to be revised, if necessary, in future periods if actual forfeitures differ from the estimates. Changes in forfeiture estimates impact compensation cost in the period in which the change in estimate occurs.

As of June 30, 2006, total compensation cost related to non-vested stock options and restricted stock not yet recognized was \$136.5 million, which is expected to be recognized over the 48 month period after June 30, 2006 (35 months on a weighted-average basis). The Company has not capitalized as part of inventory any share-based compensation costs because such costs were negligible as of June 30, 2006.

Prior to adopting the provisions of SFAS No. 123R, the Company recorded estimated compensation expense for employee and director stock options based on their intrinsic value on the date of grant pursuant to APB No. 25 and provided the *pro forma* disclosures required by SFAS No. 123. Because the Company has historically granted at-the-money stock options that have no intrinsic value upon grant, no expense was recorded for stock options prior to adopting SFAS No. 123R. For purposes of *pro forma* disclosures under SFAS No. 123, compensation expense under the fair value method and the effect on net income and earnings per common share for the three and six month periods ended June 24, 2005 were as follows:

(in millions, except per share amounts)	Three months ended June 24, 2005	Six months ended June 24, 2005
Net earnings, as reported	\$ 33.4	\$ 113.3
Add stock-based compensation expense included in reported net earnings, net of tax	2.2	4.5
Deduct stock-based compensation expense determined under fair value based method, net of tax	(12.2)	(22.9)
<i>Pro forma</i> net earnings	\$ 23.4	\$ 94.9
Earnings per share:		
As reported basic	\$ 0.26	\$ 0.87
As reported diluted	\$ 0.25	\$ 0.86
<i>Pro forma</i> basic	\$ 0.18	\$ 0.73
<i>Pro forma</i> diluted	\$ 0.18	\$ 0.72

The fair value of stock options granted during the six month period ended June 24, 2005 were estimated at grant date using the following weighted average assumptions: expected volatility of 33.4%; risk-free interest rate of 3.76%; expected dividend yield of 0.50%; and expected life of five years.

*Pro forma* amounts for the three and six month periods ended June 24, 2005 include a deduction of \$1.8 million, net of tax (\$0.01 *pro forma* basic and diluted earnings per share) due to the acceleration of the vesting of 1,159,626 premium priced stock options granted under the Allergan, Inc. 2001 Premium Priced Stock Option Plan.

#### 8. 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 U.S. retirees and dependents.

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Components of net periodic benefit cost for the three and six month periods ended June 30, 2006 and June 24, 2005, respectively, were as follows:

<u>(in millions)</u>	Three months ended			
	Pension Benefits		Other Postretirement Benefits	
	June 30, 2006	June 24, 2005	June 30, 2006	June 24, 2005
Service cost	\$ 5.7	\$ 4.6	\$ 0.7	\$0.3
Interest cost	6.8	6.3	0.4	0.4
Expected return on plan assets	(8.1)	(7.0)		
Amortization of prior service cost			(0.1)	
Recognized net actuarial loss	3.3	2.5		
Net periodic benefit cost	\$ 7.7	\$ 6.4	\$ 1.0	\$0.7

<u>(in millions)</u>	Six months ended			
	Pension Benefits		Other Postretirement Benefits	
	June 30, 2006	June 24, 2005	June 30, 2006	June 24, 2005
Service cost	\$ 11.4	\$ 9.1	\$ 1.5	\$ 0.8
Interest cost	13.6	12.6	0.9	0.7
Expected return on plan assets	(16.2)	(14.0)		
Amortization of prior service cost			(0.3)	(0.1)
Recognized net actuarial loss	6.5	4.9		
Net periodic benefit cost	\$ 15.3	\$ 12.6	\$ 2.1	\$ 1.4

In 2006, the Company expects to pay contributions of between \$14.0 million and \$16.0 million to its U.S. and non-U.S. pension plans and between \$0.7 million and \$0.8 million to its other postretirement plan.

**9. Litigation**

The following supplements and amends our 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, 2005 and the Company's quarterly report on Form 10-Q for the period ended March 31, 2006.

In June 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 Roche Palo Alto, LLC, formerly known as Syntex (U.S.A.) LLC, 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. Following a trial, the court entered final judgment in the Company's favor on January 27, 2004, holding that the patent at issue is valid, enforceable and infringed by Apotex's proposed generic drug. Following an appeal by Apotex, the United States Court of Appeals for the Federal Circuit issued an opinion in May 2005, affirming the lower court's ruling on inequitable conduct and claim construction and reversing and remanding the issue of obviousness.





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On remand, on June 2, 2006, the District Court ruled that the Defendants' ANDA infringes U.S. Patent No. 5,110,493, which is owned by Syntex and licensed by Allergan, and that the patent is valid and enforceable. On June 2, 2006, the District Court further ruled that the effective date of any approval of the Defendants' ANDA may not occur before the patent expires in 2009 and that the Defendants, and all persons and entities acting in concert with them, are enjoined from making any preparations to make, sell, or offer for sale ketorolac tromethamine ophthalmic solution 0.5% in the United States. On June 27, 2006, Apotex filed a notice of appeal with the United States Court of Appeals for the Federal Circuit. Apotex has not received final approval from the FDA to market its generic product. 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 was held on January 4, 2005 and a settlement conference previously scheduled for July 21, 2006 was taken off calendar by the court and has not yet been rescheduled.

***Inamed Related Matters Assumed in Our Acquisition of Inamed***

In connection with its purchase of Collagen in September 1999, the Company's subsidiary Inamed assumed certain liabilities relating to the Trilucent breast implant, a soybean oil-filled breast implant, which had been manufactured and distributed by various subsidiaries of Collagen between 1995 and November 1998. In November 1998, Collagen announced the sale of its LipoMatrix, Inc. subsidiary, manufacturer of the Trilucent implant to Sierra Medical Technologies, Inc. Collagen retained certain liabilities for Trilucent implants sold prior to November 1998.

In March 1999, the United Kingdom Medical Devices Agency, or MDA, announced the voluntary suspension of marketing and withdrawal of the Trilucent implant in the United Kingdom as a precautionary measure. The MDA did not identify any immediate hazard associated with the use of the product but stated that it sought the withdrawal because it had received reports of local complications in a small number of women who had received those implants, involving localized swelling. The same notice stated that there has been no evidence of permanent injury or harm to general health as a result of these implants. In March 1999, Collagen agreed with the U.K. National Health Service that, for a period of time, it would perform certain product surveillance with respect to U.K. patients implanted with the Trilucent implant and pay for explants for any U.K. women with confirmed Trilucent implant ruptures. Subsequently, LipoMatrix's notified body in Europe suspended the product's CE Mark pending further assessment of the long-term safety of the product. Sierra Medical has since stopped sales of the product. Subsequent to acquiring Collagen, Inamed elected to continue the voluntary program.

In June 2000, the MDA issued a hazard notice recommending that surgeons and their patients consider explanting the Trilucent implants even if the patient is asymptomatic. The MDA also recommended that women avoid pregnancy and breast-feeding until the explantation as a precautionary measure stating that although there have been reports of breast swelling and discomfort in some women with these implants, there has been no clinical evidence of any serious health problems, so far.

Concurrently with the June 2000 MDA announcement, Inamed announced that, through its AEI, Inc. subsidiary, it had undertaken a comprehensive program of support and assistance for women who have received Trilucent breast implants, under which it was covering medical expenses associated with the removal and replacement of those

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implants for women in the European Community, the United States and other countries. After consulting with competent authorities in each affected country, Inamed terminated this support program in March 2005 in all countries other than the United States and Canada. Notwithstanding the termination of the general program, Inamed continued to pay for explantations and related expenses in certain cases if a patient justified her delay in having her Trilucent implants removed on medical grounds or owing to lack of notice. Under this program, Inamed may pay a fee to any surgeon who conducts an initial consultation with any Trilucent implantee. Inamed also pays for the explantation procedure and related costs, and for replacement (non-Trilucent) implants for women who are candidates for and who desire them. To date, virtually all of the U.K. residents and more than 95% of the non-U.K. residents who have requested explantations as a result of an initial consultation have had them performed.

A Spanish consumer union has commenced a single action in the Madrid district court in which the consumer union, Avinesa, alleges that it represents 41 Spanish Trilucent explantees. To date, 64 women in Spain have commenced individual legal proceedings in court against Inamed, of which approximately 30 were still pending as of June 30, 2006. Prior to the issuance of a decision by an Appellate Court sitting in Madrid in the second quarter of 2005, Inamed won approximately one-third, and lost approximately two-thirds of its Trilucent cases in the lower courts. The average damages awarded in cases the Company lost were approximately \$18,000. In the second quarter of 2005, in a case called Gomez Martin v. AEI, for the first time an appellate court in Spain issued a decision holding that Trilucent breast implants were not defective within the meaning of applicable Spanish product liability law and dismissed a \$60,000 award issued by the lower court. While this ruling is a positive development for Inamed, it may not be followed by other Spanish appellate courts or could be modified or found inapplicable to other cases filed in the Madrid district. Since the ruling in Gomez Martin v. AEI, Inamed has had greater success in winning the Spanish cases than before the ruling.

As of June 30, 2006, Inamed has approximately \$0.5 million of insurance coverage remaining under a settlement between Inamed and AISLIC, an AIG company, for the indemnification of non-U.S. Trilucent claims. In addition, at June 30, 2006, Inamed had an accrual for future Trilucent claims, costs, and expenses of approximately \$1.4 million and insurance of \$0.5 million, or \$0.9 million, net of insurance. There can be no assurances that future Trilucent-related liabilities will not exceed the current accruals and insurance coverage.

In May 2002, Ernest Manders filed a lawsuit against Inamed and other defendants entitled Ernest K. Manders, M.D. v. McGhan Medical Corporation, et al., in the United States District Court for the Western District of Pennsylvania, Case No. 02-CV-1341. Manders' amended complaint seeks damages for alleged infringement of a patent allegedly held by Manders in the field of tissue expanders. In February 2003, Inamed answered the complaint, denying its material allegations and counterclaiming against Manders for declarations of invalidity as well as noninfringement. Following fact discovery and expert discovery, Manders elected to limit his claim for infringement to twelve of the forty-six claims in his patent. In September 2004 and October 2004, the court held a Markman hearing on claim construction under the patent and in February 2006, the court issued its Memorandum Opinion on claim construction. The court held a status conference on April 21, 2006 and another status conference on May 5, 2006, at which time the court indicated that it would refer the case to a magistrate for mediation. On June 20, 2006, the parties participated in mediation but were unable to reach a settlement. The court is expected to schedule a status conference to discuss the pending motion for reconsideration of the court's claim construction order and to set the remaining pretrial schedule, including expert discovery.

The Company is involved in various other lawsuits and claims arising in the ordinary course of business. These other matters are, in the opinion of management, immaterial both individually and in the aggregate with respect to the Company's consolidated financial position, liquidity or results of operations.

Under U.S. generally accepted accounting principles, the Company establishes an accrual for an estimated loss contingency when it is both probable that an asset has been impaired or that a liability has been incurred and the

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amount of the loss can be reasonably estimated. Given the uncertain nature of litigation generally, and the uncertainties related to the incurrence, amount and range of loss on any pending litigation, investigation or claim, the Company 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. While the Company believes 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 its consolidated financial position, liquidity or results of operations, in view of the uncertainties discussed above, it could incur charges in excess of any currently established accruals and, to the extent available, excess liability insurance. In addition, an adverse ruling in a patent infringement lawsuit involving the Company could materially affect its 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 it 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.

## 10. Guarantees

The Company's 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