PYRAMID OIL CO
Form DEF 14A
April 27, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No. __________)

Filed by the Registrant þ
Filed by a Party other than the Registrant o
Check the appropriate box:
o Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
þ Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to Section 240.14a-12

Pyramid Oil Company
(Name of Registrant as Specified in Its Charter)
(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):
þ No fee required
o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

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(1) Amount Previously Paid:

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(3) Filing Party:

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PYRAMID OIL COMPANY
2008 21st Street P.O. Box 832
Bakersfield, California 93302
NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
June 17, 2010

To our shareholders:

Notice is hereby given that the Annual Meeting of Shareholders (the **Annual Meeting**) of Pyramid Oil Company (the **Company**) will be held at the corporate offices of Pyramid Oil Company, 2008-21st Street, Bakersfield, California 93301, on Thursday, June 17, 2010 at 10:30 A.M. Pacific Daylight Time, for the following purposes:

1. To approve an amendment to the Company s Restated Articles of Incorporation and Amended and Restated Bylaws to change the authorized number of directors from a fixed number of seven to a minimum number of four and a maximum number of seven directors, with the initial number of authorized directors to be four, and to delete references in the Restated Articles of Incorporation to the Company s principal place of business;
2. To elect a Board of Directors to hold office until the 2011 annual meeting of shareholders;
3. To approve the selection of SingerLewak LLP as the Company s independent registered public accounting firm for the year ending December 31, 2010; and
4. To transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

Information concerning these matters, including the names of the nominees for the Board of Directors of the Company (the **Board**), is set forth in the attached Proxy Statement for the Annual Meeting. Holders of record of the Company s Common Stock at the close of business on April 30, 2010, the record date fixed by the Board, are entitled to notice of and to vote at the Annual Meeting. The Board urges that all shareholders of record to exercise their right to vote personally at the meeting or by proxy.

A copy of the Company s Annual Report to Shareholders containing financial statements and other information of interest to shareholders is enclosed herewith. You are urged to read the Annual Report.

All shareholders are requested to read the enclosed Proxy Statement and to sign, date and complete the enclosed proxy and return it promptly in the accompanying postage prepaid, pre-addressed envelope, whether or not they intend to attend the meeting, to assure that their shares will be represented. Any shareholder giving a proxy has the right to revoke it at any time before it is voted by following the procedures outlined in the Proxy Statement. Your prompt response will be appreciated.

By Order of the Board of Directors
Lee G. Christianson, Secretary
Bakersfield, California
May 17, 2010

PLEASE SIGN AND DATE THE ENCLOSED FORM OF PROXY AND MAIL IT PROMPTLY IN THE ENCLOSED RETURN ENVELOPE, IN ORDER TO ASSURE THAT YOUR VOTES ARE COUNTED.

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PYRAMID OIL COMPANY
2008 21st Street
P.O. Box 832
Bakersfield, California 93302
PROXY STATEMENT
ANNUAL MEETING OF SHAREHOLDERS
June 17, 2010

This Proxy Statement is furnished in connection with the solicitation by the Board of Directors (the **Board**) of Pyramid Oil Company (the **Company**) of proxies to be used at the Annual Meeting of Shareholders of the Company (the **Annual Meeting**) to be held on June 17, 2010, and at any postponement or adjournment thereof. This Proxy Statement, together with the accompanying proxy, is first being mailed to shareholders on or about May 17, 2010. You are requested to sign, date and return the enclosed proxy card in order to ensure that a majority of the outstanding shares of common stock of the Company (the **Common Stock**) are represented at the meeting.

Any proxy given by a shareholder of the Company may be revoked at any time before it is voted by attending the Annual Meeting and voting in person or by filing with the Secretary of the Company an instrument revoking the proxy or a duly executed proxy bearing a later date. If the enclosed form of proxy is properly executed and returned, the Common Stock represented thereby will be voted in accordance with the instructions given by the proxy. IF NO INSTRUCTIONS ARE GIVEN, THE COMMON STOCK WILL BE VOTED FOR (1) AMENDMENT OF THE COMPANY S RESTATED ARTICLES OF INCORPORATION AND AMENDED AND RESTATED BYLAWS IN THE MANNER DESCRIBED HEREIN; (2) APPROVAL OF THE ELECTION OF THE NOMINEES FOR DIRECTORS NAMED HEREIN; AND (3) THE RATIFICATION OF THE COMPANY S SELECTION OF SINGERLEWAK LLP AS THE COMPANY S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2010. If any other matters are properly presented at the meeting, or any adjournment thereof, the persons voting the proxies will vote according to their best judgment.

Solicitation of proxies will be primarily by mail, although some solicitation will be by telephone, telegraph or personal interview. Proxies may be solicited by officers, directors and regular employees of the Company. The Company will not pay any additional compensation for such solicitations. Arrangements may be made with brokerage houses and with the Company s transfer agent, Computershare, Glendale, California, to send notices, proxy statements, proxies and other materials to shareholders. The cost for such services is expected to be nominal and will be borne by the Company.

To minimize the Company s expenses, one Proxy Statement and 2009 Annual Report to Shareholders may be delivered to two or more shareholders who share an address unless the Company has received contrary instructions from one or more of the shareholders. The Company will deliver promptly upon written or oral request a separate copy of the Proxy Statement and Annual Report to a shareholder at a shared address to which a single copy of the Proxy Statement and Annual Report was delivered. Requests for additional copies of the Proxy Statement and Annual Report, and requests that in the future separate documents be sent to shareholders who share an address, should be delivered by writing to Pyramid Oil Company, P.O. Box 832, Bakersfield, California 93302, Attention: Lee G. Christianson, or by calling Mr. Christianson at (661) 325-1000.

If you share an address with another shareholder and have received multiple copies of the Company s proxy materials, you may write or call the Company at the address set forth in the preceding paragraph to request delivery of a single copy these materials.

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Important Notice Regarding the Internet Availability of Proxy Materials for the Shareholder Meeting to be Held on June 17, 2010

This Proxy Statement, the accompanying proxy and the Company s 2009 Annual Report to Shareholders are also available on the following website at http://www.edocumentview.com/PDO.

RECORD DATE AND VOTING

Only holders of record of the Company s Common Stock at the close of business on April 30, 2010 shall be entitled to notice of and to vote at the Annual Meeting. Transferees of Common Stock which is transferred on the books of the Company subsequent to such date shall not be entitled to notice of or to vote at the Annual Meeting with respect to such transferred Common Stock.

As of April 30, 2010, there were outstanding 4,677,728 shares of Common Stock. A majority of the outstanding shares of Common Stock, whether present in person or by proxy, constitutes a quorum for the conduct of business at the Annual Meeting.

Brokers who hold shares of Common Stock for the accounts of their clients may vote such shares either as directed by their clients or in their own discretion if permitted by the stock exchanges or other organizations of which they are members. Members of the New York Stock Exchange (the "**NYSE**) are permitted by NYSE Rule 452 to vote their clients proxies in their own discretion on certain routine matters, such as the ratification of the selection of a company s independent registered public accounting firm, if the clients have not furnished voting instructions within ten days of the Annual Meeting. However, Rule 452 defines various proposals such as the election of directors as non-discretionary, and brokers who have received no instructions from their clients do not have discretion to vote on those items. When a broker votes a client s shares on some but not all proposals at a meeting, the withheld votes are referred to as broker non-votes.

Abstentions will count for purposes of establishing a quorum but will not count as votes cast for the election of directors or regarding any other proposal. Shares held by brokers who vote such shares on any proposal will be counted for purposes of establishing a quorum, and broker non-votes on other proposals will not affect the presence of a quorum.

Approval of the amendment of the Company s Restated Articles of Incorporation and Amended and Restated Bylaws requires the affirmative vote of a majority of the Company s outstanding shares of Common Stock, provided that, under applicable California law, votes cast against the proposal may not exceed 16-2/3% of the Company s outstanding shares of Common Stock in order for the proposal to be approved. For purposes of determining whether the proposal has received the affirmative vote of a majority of the Company s outstanding shares, abstentions and broker non-votes will have the same effect as votes cast against the proposal, although abstentions and broker non-votes will not be counted for purposes of determining whether the holders of more than 16-2/3% of the outstanding shares have voted against the proposal.

Approval of the selection of SingerLewak LLP requires the affirmative vote of the holders of a majority of the shares of Common Stock represented in person or by proxy and voting on the item, provided that the shares voting affirmatively must also constitute a majority of the required quorum for the Annual Meeting. Therefore, abstentions and broker non-votes will not affect the outcome of that proposal, assuming that the required vote described in the preceding sentence is obtained.

With regard to the election of directors, the four nominees receiving the greatest number of votes will be elected. Therefore, abstentions and broker non-votes will not affect the outcome of the election of directors.

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Unless cumulative voting is requested by a shareholder, each share of Common Stock is entitled to one vote for the election of each director of the Company and to one vote on every other matter to be voted upon at the Annual Meeting. Under the California General Corporation Law, if a shareholder gives notice prior to the commencement of voting on the election of directors of his or her intention to cumulate his or her votes, then all shareholders (or their proxies) may cumulate their votes in connection with the election of directors. No cumulative voting will occur if no such notice is given. Cumulative voting permits each shareholder to cast an aggregate number of votes equal to the number of shares owned multiplied by the number of directors to be elected; all of such votes may be cast for a single nominee or may be allocated among any two or more nominees as the shareholder wishes.

If a proxy is marked FOR the election of directors, it may, at the discretion of the persons named in the enclosed form of proxy (the **Proxy Holders**), be voted cumulatively in the election of directors. Under either form of voting, the four nominees receiving the highest number of votes cast will be elected as directors.

If you hold your shares of Common Stock in street name through a broker, bank or other nominee, you are not entitled to vote those shares directly. Instead, you need to instruct the broker or other record owner of your shares as to the voting of the shares using the procedure provided to you by your broker, bank or other nominee. In most cases, you will receive a voting instruction form from your broker, bank or other nominee.

PROPOSAL 1
AMENDMENT OF THE COMPANY S RESTATED ARTICLES OF INCORPORATION AND AMENDED AND RESTATED BYLAWS

The Company s Restated Articles of Incorporation and Amended and Restated Bylaws provide that the authorized number of directors of the Company is seven. The Board has approved an amendment to each of those charter documents providing that the authorized number of directors of the Company will be not less than four nor more than seven, with the exact number of directors within those limits to be four unless and until that number of authorized directors is changed, within the specified limits, by a resolution which is duly adopted by the Board.

The Board is requesting the Company s shareholders to approve the amendment described in the preceding paragraph. The amendment to the Restated Articles of Incorporation will be reflected in new Restated Articles of Incorporation in the form of Appendix A to this Proxy Statement, which is marked to show changes from the current Restated Articles of Incorporation. Appendix B to this Proxy Statement sets forth the proposed amendment to Article II, Section C of the Company s Amended and Restated Bylaws to conform to the proposed amendment to the Restated Articles of Incorporation. The summary of the amendments contained in this Proxy Statement is qualified by the full text of the amendments set forth in Appendices A and B.

The Board has had fewer than seven directors in office for several years. The Board believes that, given the current size and operations of the Company, there is no need to have seven directors and that four directors are sufficient to enable the Board to function efficiently and to meet the needs of the shareholders.

The Board is also requesting the Company s shareholders to approve minor amendments to the Restated Articles of Incorporation that (1) will delete the current reference in the Restated Articles of Incorporation to the Company s principal place of business as being in the County of Los Angeles, California and (2) will make several non-substantive editorial changes. For many years, the Company s principal executive office has been located in Bakersfield, California, and the California General Corporation Law does not require a corporation s articles of incorporation to state the location of its principal place of business. Article I, Section A of the Company s Amended and Restated Bylaws states that the Board will determine the location of the Company s principal executive office.

If the Company s shareholders approve these amendments at the Annual Meeting, the Company will file the Restated Articles of Incorporation with the California Secretary of State, and the amendments will be effective upon such filing. Shareholder approval of the proposed amendments shown in Appendix A is also deemed to constitute approval of the filing with the California Secretary of State of the new Restated Articles of Incorporation. The Board does not believe that the proposed amendments described above will have any effect on the ability of the Company s shareholders to cause a change in control of the Company.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE APPROVAL OF THE AMENDMENTS DESCRIBED ABOVE TO THE COMPANY S RESTATED ARTICLES OF INCORPORATION AND AMENDED AND RESTATED BYLAWS.

PROPOSAL 2
ELECTION OF DIRECTORS

Directors are to be elected at the Annual Meeting to serve until the next annual meeting and until their successors are elected and qualified. Unless otherwise instructed in the proxy card, it is the intention of the Proxy Holders to vote for the election of the following four persons as directors: John H. Alexander, Michael D. Herman, Gary L. Ronning and John E. Turco. Thomas W. Ladd, who has served as a director since 1998, has advised us that he does not desire to stand for re-election as a director at the Annual Meeting and that his service as a director therefore will terminate on June 17, 2010.

The Board has been informed that all nominees are willing to serve as directors. If any of them should decline or be unable to act as a director, the Proxy Holders will vote for the election of another person or persons as they, in their discretion, may choose. The Board has no reason to believe any nominee will be unable or unwilling to serve. The information provided below summarizes each nominee s specific experience, qualifications, attributes and/or skills that led the Board to conclude that he is qualified to serve as a director of the Company.

The nominees for election as directors of the Company are as follows:

Name	Age	Position (1)	Director Since	Officer Since
Michael D. Herman	52	Chairman of the Board and Director	2005	
John H. Alexander	62	President, Chief Executive Officer and Director	1984	1986
Gary L. Ronning	67	Director	1998	
John E. Turco	79	Director	1996	

(1) Position listed is that held with the Company.

MICHAEL D. HERMAN

Mr. Herman has been Chairman of the Company s Board since July 2005 and the largest shareholder of the Company since June 15, 2005. Mr. Herman is the Chairman and sole shareholder of Heat Waves Oil Service, LLC and Dillco. Heat Waves and Dillco provide various energy-related services such as water hauling and disposal, acidizing, frac heating and hot oil services to customers in Kansas, Oklahoma, Colorado, Utah, Wyoming, Pennsylvania and New Mexico. Mr. Herman was the Chairman and owner of Pasadena, California based Key Food Ingredients, Inc. from January 1, 2005 until October, 2007. Key Food Ingredients supplies dehydrated vegetables from its factory in Qingdao, China to customers worldwide. Mr. Herman was Chairman and owner of Telematrix, Inc. from October 1992 until December 1998, when that company was sold to a major hospitality company, and he repurchased a majority ownership interest in December 2004 and

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held that majority ownership interest until April 2006. Telematrix, Inc. designs and distributes communications products and telephones to hospitality and business customers globally. From November 2003 until February 2005, Mr. Herman was Chairman and majority shareholder of Ft. Lauderdale based Sunair Electronics but chose not to stand for re-election as a director in February 2006. Sunair Electronics is engaged in the design, manufacture and sale of high frequency communications equipment for long-range voice and data applications.

Mr. Herman has been active in the oil and gas producing and servicing business since the mid-1980 s. His broad experience in the oil and gas industry and diverse business experience outside the oil and gas industry are valuable resources to our Board in formulating business strategy, addressing business opportunities and resolving operational issues that arise from time to time.

JOHN H. ALEXANDER

Mr. Alexander has been an independent oil operator in Orange County, California since 1970. From 1972 to 1974, Mr. Alexander was an officer and a director of Transierra Exploration Corporation, a public company located in Newport Beach, California. Mr. Alexander has served as a director of Pyramid Oil Company since 1986; from 1986 to 2004, he served as its Vice President, and he has served as its President and Chief Executive Officer since June 3, 2004. Mr. Alexander has served for the past 20 years as a director of Valley Waste Disposal Company, a non-profit oilfield related service company located in Bakersfield, California.

Mr. Alexander has 40 years of experience in the oil and gas industry, including 24 years with the Company. Mr. Alexander s industry experience and extensive knowledge of the Company s oil and gas operations are an important contribution to the Board. Mr. Alexander is the only member of management who serves on the Board.

GARY L. RONNING

Mr. Ronning had been Executive Vice President, Western Region of Prime Natural Resources, LLC, since 1999. Mr. Ronning previously worked with Ferguson Energy, an independent oil and gas exploration company beginning in 1967. Mr. Ronning also has had several positions with Ferguson Energy, managing operations and production in several states.

Mr. Ronning has been engaged in all aspects of the oil and gas industry continuously since 1967. Mr. Ronning brings to the Board a range and length of industry experience that is a unique asset.

JOHN E. TURCO

Mr. Turco has been the President and Chief Financial Officer of the Corotto Company, an agricultural company growing citrus in Kern County, California, since March 1991. Mr. Turco is a member of the California Citrus Research Board, serving as the first Chairman of its Finance Committee and continuing to serve as a member of its Finance Committee. Mr. Turco has also served as a director of Coast RV and as a trustee of the Menlo School. Mr. Turco has twenty years of experience in the fire and casualty insurance business and has been a member of Lloyd s of London since 1975. Mr. Turco also attained the rank of Colonel in the United States Marines Corps Reserve.

Mr. Turco s diverse business experience and board service provide him with a wide range of expertise that is valuable to our Board in confronting various business-related challenges and opportunities.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF THE NOMINEES NAMED ABOVE.

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EXECUTIVE OFFICERS OF THE COMPANY

Name	Age	Position (1)	Officer Since
John H. Alexander	62	President, Chief Executive Officer and Director	1986

The biographical description of Mr. Alexander is included under Election of Directors.

SECURITY OWNERSHIP OF DIRECTORS, OFFICERS AND NOMINEES

The following table sets forth certain information as of April 30, 2010, with respect to beneficial ownership of the Company s Common Stock by each of the Company s directors, director nominees and executive officers named below in the executive compensation table and by all directors and executive officers as a group. The number of shares owned are those beneficially owned, as determined under rules of the Securities and Exchange Commission (the **SEC**). The information disclosed below is not necessarily indicative of beneficial ownership for any other purpose. Beneficial ownership as described below includes any shares of Common Stock as to which the person named below has sole or shared voting power or investment power pursuant to a discretionary account or similar arrangement.

Name and Title (1)	Shares Owned (2)	Percentage of Outstanding Common Stock (3)
Michael D. Herman Director, Chairman of the Board	1,703,410	36.4%
John H. Alexander, Director President and Chief Executive Officer	95,592	2.0%
Thomas W. Ladd, Director	31	
Gary L. Ronning, Director	125	
John E. Turco, Director	229,085(4)	4.9%
Directors and Executive Officers as a Group (6 Persons)	2,028,243	43.3%

(1) The title listed refers to the individual s position with the Company.

(2) Amounts reported by each director do not include shares held in the name of his spouse, children and other relatives because the director does not have sole or shared voting or investment control over the shares.

(3) As a percentage of the 4,677,728 shares of Common Stock outstanding at April 30, 2010.

(4) Mr. Turco owns 50% of the Corotto Company. which in turn owns 27,188 shares of the Company. Such shares are included in the total shares owned.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under the federal securities laws, the Company s directors, executive officers, and any person holding more than 10% of the Company s Common Stock are required to report their ownership of the Company s securities and any changes in that ownership to the SEC. Specific due dates for these reports have been established, and the Company is required to report any failures to file by these dates. The Company knows of no instances of persons who have failed to file or have delinquently filed Section 16(a) reports within the most recently completed fiscal year.

BOARD COMMITTEES; DIRECTOR NOMINATING PROCESS; SHAREHOLDER COMMUNICATIONS WITH THE BOARD; BOARD LEADERSHIP STRUCTURE AND ROLE IN RISK OVERSIGHT

The members of the Audit Committee and Compensation Committee are Thomas W. Ladd, Gary L. Ronning and John E. Turco. The Board has determined that directors Ladd, Ronning and Turco are "independent within the meaning of Rule 10A-3(b)(1) under the Securities Exchange Act of 1934 and Section 303A.02 of the NYSE Amex Company Guide. In addition, the Board has determined that director Herman is independent under Section 303A.02 of the NYSE Amex Company Guide, and that director Alexander is not independent since he is an employee of the Company. Mr. Ladd does not intend to stand for re-election at the Annual Meeting.

The Audit Committee reviews the Company s financial and accounting organization, financial reporting and the reports of the independent registered public accounting firm and is responsible for the selection and oversight of the independent registered public accounting firm. The Board has determined that Mr. Turco is an audit committee financial expert within the meaning of Item 407(d)(5) of the SEC s Regulation S-K. The Board based its determination upon Mr. Turco s experience since March 1991 as the Chief Financial Officer of the Corotto Company.

The Audit Committee held four meetings during the last fiscal year. All of the Company s directors who were members of the Audit Committee attended all of the Audit Committee meetings. A copy of the Audit Committee s charter is available on the Company s website at www.pyramidoil.com.

The Compensation Committee recommends and approves the compensation of the Company s directors and executive officers, including approving individual executive officer compensation, and reviews and recommends to the Board compensation plans, policies and benefit programs for employees generally. The Compensation Committee held one meeting during the last fiscal year. All of the Company s directors who were members of the Compensation Committee attended that Compensation Committee meeting. A copy of the Compensation Committee s charter is available on the Company s website at www.pyramidoil.com.

All directors of the Company comprise the Nominating Committee, which recommends prospective directors to fill vacancies that may arise from time to time and proposes individuals for election to the Board by the Company s shareholders. The Nominating Committee held one meeting during the last fiscal year. All of the Company s directors attended the Nominating Committee meeting. The Nomination Committee does not have a separate written charter.

The Board, in its capacity as the Company s Nominating Committee, will consider shareholder nominations for candidates for membership on the Board. In evaluating such nominations, the Board seeks to achieve a balance of knowledge, experience and capability on the Board. Any shareholder nominations proposed for consideration by the Board should include the nominee s name and qualifications for Board membership and should be addressed to Lee G. Christianson, Secretary, Pyramid Oil Company, P.O. Box 832, Bakersfield, California 93302. Shareholder nominations should be delivered to Mr. Christianson at least 120 days before the date of the annual meeting.

The Board believes that directors should have the highest professional and personal ethics and values, consistent with longstanding Company values and standards. They should have broad experience at the policy-making level in business, government, education, technology or public interest. They should be committed to enhancing shareholder value and should have sufficient time to carry out their duties and to provide insight and practical wisdom based on experience. Their service on other boards of public companies should be limited to a number that permits them, given their individual circumstances, to perform responsibly all director duties.

The Board utilizes a variety of methods for identifying and evaluating nominees for director. The Board periodically assesses the appropriate size of the Board and whether any vacancies on the Board are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the Board will consider various potential candidates for director. Candidates may come to the attention of the Board s through current Board members, professional search firms, shareholders or other persons. These candidates will be evaluated at regular or special meetings of the Board, and may be considered at any point during the year. If any materials are provided by a shareholder in connection with the nomination of a director candidate, the materials will be forwarded to the Board. The Board will also review materials provided by professional search firms or other parties in connection with a nominee who is not proposed by a shareholder. Although the Board believes that director nominees should add to the range of backgrounds and experiences of the Company s directors, the Board does not have a policy regarding the consideration of diversity in identifying and evaluating director nominees.

All four of the director nominees identified in this Proxy Statement currently serve as directors of the Company.

Any shareholder can communicate with all directors or with specified directors by sending a letter to the Company s Corporate Secretary at the address listed above. All such letters will be forwarded to the entire Board or to the directors specified by the shareholder.

Michael D. Herman serves as the Company s Chairman of the Board, and John H. Alexander serves as the Company s President and Chief Executive Officer. The Board believes that having two persons, rather than only one, serve in these positions assists the Board in performing its obligation to oversee senior management.

The full Board has responsibility for general oversight of risks facing the Company. The Board receives reports from senior management on areas of risk facing the Company and periodically conducts discussions regarding risk assessment and risk management.

BOARD MEETINGS AND COMPENSATION OF DIRECTORS

The Board held four meetings in 2009. Only non-employee directors receive payment for service as directors of the Company. Non-employee directors receive $600 for each Board meeting attended in person. Each Board meeting was attended by all of the directors, except for Mr. Turco who attended three meetings in 2009.

The following table sets forth information concerning the compensation paid to non-employee directors during 2009 for their services as directors.

Name	Fees Earned or Paid In Cash	All Other Compensation	Total
Michael D. Herman	$ 600	$ -0-	$ 600
Thomas W. Ladd	$ 2,400	$ -0-	$2,400
Gary L. Ronning	$ 2,400	$ -0-	$2,400
John E. Turco	$ 1,800	$ -0-	$1,800

Each director is encouraged to attend each annual meeting of shareholders. All directors attended the 2009 annual meeting of shareholders.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee oversees and monitors the participation of the Company s management and independent registered public accounting firm throughout the financial reporting process. Other than their services as directors of the Company, no member of the Audit Committee has any other material relationship with the Company.

In connection with its function to oversee and monitor the financial reporting process, the Audit Committee has, among other things: reviewed and discussed with the Company s management the audited financial statements for the fiscal year ended December 31, 2009, discussed with the Company s independent registered public accounting firm those matters required to be discussed by Statement on Auditing Standards No. 61, as amended (AICPA, *Professional Standards*, Vol. 1, AU Section 380) as adopted by the Public Company Accounting Oversight Board in Rule 3200T; and received the written disclosures and letter from the Company s independent registered public accounting firm required by applicable requirements of the Public Company Accounting Oversight Board regarding such firm s communications with the Audit Committee concerning independence and discussed with the Company s independent registered public accounting firm their independence from the Company.

Based upon the foregoing, the Audit Committee recommended to the Board that the Company s audited financial statements be included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

Thomas W. Ladd   Gary L. Ronning   John E. Turco

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EXECUTIVE COMPENSATION

The following table sets forth the compensation for the 2009 and 2008 fiscal years for the Chief Executive Officer (**CEO**) as indicated below. The Company has not granted any stock options or stock appreciation rights to the CEO. No other executive officer had total compensation in excess of $100,000 for the 2009 fiscal year.

Name and Position	Year	Salary (1)	Bonus (1)	Total
John H. Alexander	2009	$138,400	$25,000	$163,400
President and Chief				
Executive Officer	2008	$134,233	$50,000	$184,233

(1) Perquisites and other personal benefits provided to the CEO were less than $10,000 in the aggregate for each of the 2009 and 2008 fiscal years and, in accordance with applicable SEC regulations, they are not listed in this table. Mr. Alexander became the Company s CEO on June 2, 2004.

EXECUTIVE EMPLOYMENT AGREEMENTS

The Company has an employment agreement with Mr. John H. Alexander, the Company s President and Chief Executive Officer.

In February 2002, the Company entered into an employment agreement with John H. Alexander pursuant to which Mr. Alexander agreed to serve as the Company s Vice President. On June 3, 2004, Mr. Alexander was appointed as the Company s President and Chief Executive Officer. The employment agreement is for an initial term of five years, which term automatically renews annually if written notice is not tendered. Pursuant to the employment agreement, the Company may terminate Mr. Alexander s employment with or without cause at any time before its term expires upon providing written notice. In the event the Company terminates Mr. Alexander s employment without cause, Mr. Alexander would be entitled to receive a severance amount equal to his annual base salary and benefits for the balance of the term of his employment agreement. In the event of termination by reason of Mr. Alexander s death or permanent disability, his legal representative will be entitled to receive his annual salary and benefits for the remaining term of his employment agreement. In the event of, or termination following, a change in control of the Company, as defined in the agreement, Mr. Alexander would be entitled to receive his annual salary and benefits for the remainder of the term of his agreement.

On January 9, 2007, the Company and John Alexander entered into a Severance Award Agreement pursuant to which the Company awarded Mr. Alexander a supplemental payment in connection with his future severance of employment with the Company. Pursuant to the Severance Award Agreement and following the termination of Mr. Alexander s employment, he will be entitled to receive (at the Company s option) 25,000 shares of the Company s

Common Stock or the then fair market value of the shares. The closing price of a share of the Company s Common Stock on March 13, 2010 was $7.25.

On December 30, 2008, the Company and John Alexander entered into a Severance Award Agreement pursuant to which the Company awarded Mr. Alexander an additional supplemental payment in connection with his future severance of employment with the Company. Pursuant to the Severance Award Agreement and following the termination of Mr. Alexander s employment, he will be entitled to receive (at the Company s option) 25,000 shares of the Company s Common Stock or the then fair market value of the shares.

On June 4, 2009, the Company and John Alexander entered into a Severance Award Agreement pursuant to which the Company awarded Mr. Alexander an additional supplemental payment in connection with his future severance of employment with the Company. Pursuant to the Severance Award Agreement and

following the termination of Mr. Alexander s employment, he will be entitled to receive (at the Company s option) 25,000 shares of the Company s Common Stock or the then fair market value of the shares.

RETIREMENT AND EMPLOYEE BENEFIT PLANS

The Company has a defined contribution plan (Simple IRA) available to all employees meeting certain service requirements. Employees may contribute up to a maximum of $6,000 of their annual compensation to the plan. The Company makes a mandatory contribution to the plan in an amount equal to the employees contributions of up to 3% of their annual compensation. Contributions of $10,428, $12,834 and $13,119 were made by the Company during the years ended December 31, 2009, 2008 and 2007, respectively.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Effective January 1, 1990, John H. Alexander participated with a group of investors that acquired the mineral and fee interest on one of the Company s oil and gas leases (Santa Fe Energy lease) in the Carneros Creek field after the Company declined to participate. The thirty-three percent interest owned by Mr. Alexander represents a minority interest in the investor group. Royalties on oil and gas production from this property paid to the investor group approximated $188,500 in 2009, $462,800 in 2008 and $324,700 in 2007.

As a director, Mr. Alexander has abstained from voting on any of the above matters that have been brought before the Board involving the Santa Fe lease.

PRINCIPAL HOLDERS OF SECURITIES

The following table furnishes information as of April 30, 2010, as to each person known to the Company to be a beneficial owner of more than 5% of the Company s Common Stock.

Name and Address	Number of Beneficially Owned Shares	Percentage of Outstanding Common Stock
Michael D. Herman P. O. Box 60446 Colorado Spring, Colorado 80960	1,703,410	36.4%

PROPOSAL 3

APPROVAL OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has appointed SingerLewak LLP as the independent registered public accounting firm to audit the books, records and accounts of the Company for the year ending December 31, 2010. The appointment is being presented to the shareholders for their ratification. Representatives of SingerLewak LLP will be present at the meeting. They will have an opportunity to make statements if they desire and will be available to respond to appropriate questions.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE APPROVAL OF SINGERLEWAK LLP AS THE COMPANY S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2010. IN THE EVENT THAT THE SHAREHOLDERS DO NOT RATIFY THE APPOINTMENT, THE APPOINTMENT WILL BE RECONSIDERED BY THE AUDIT COMMITTEE.

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PRINCIPAL AUDITOR FEES AND SERVICES

The following table shows the fees billed to the Company by SingerLewak LLP for the audit and other services rendered by SingerLewak LLP during fiscal 2009 and 2008.

	2009	2008
Audit Fees (1)	$174,000	$185,600
Audit-Related Fees		
Tax Fees		
All Other Fees		

(1) Audit fees represent fees for professional services provided to the Company in connection with the audit of the Company s financial statements and review of the Company s quarterly financial statements and audit services provided in connection with other statutory or regulatory filings.

All audit-related services and other services rendered by SingerLewak LLP were pre-approved by the Audit Committee. The Audit Committee has a pre-approval policy that requires the pre-approval by the Audit Committee of all services performed for the Company by SingerLewak LLP.

ANNUAL REPORT TO SHAREHOLDERS

Accompanying this Proxy Statement is a copy of the Company s 2009 Annual Report to Shareholders.

SHAREHOLDER PROPOSALS FOR THE 2011 ANNUAL MEETING OF SHAREHOLDERS

A shareholder wishing to offer a proposal at the next annual meeting for inclusion in the Company s proxy statement pursuant to SEC Rule 14a-8 must submit the proposal to the Company s Secretary no later than January 18, 2010. Proposals should be mailed to Lee G. Christianson, Pyramid Oil Company, P.O. Box 832, Bakersfield, California 93302.

If notice of a shareholder proposal that the shareholder does not desire to include in the Company s proxy statement is not received by the Company s Secretary by April 4, 2011, the persons named in our proxy for the next annual meeting of shareholders will have discretionary authority to vote on the proposal at the annual meeting in accordance with their best judgment.

OTHER MATTERS

The Board is not aware of any other matters to be presented at the Annual Meeting. If any other matters should properly come before the Annual Meeting, the Proxy Holders will vote the proxies received according to their best judgment.

The Company filed an Annual Report on Form 10-K for the year ended December 31, 2009 with the Securities and Exchange Commission. Shareholders may obtain a copy of this report, without charge, by writing to Lee G. Christianson, Secretary, Pyramid Oil Company, P.O. Box 832, Bakersfield, California 93302.

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APPENDIX A
PROPOSED RESTATED ARTICLES OF INCORPORATION OF PYRAMID OIL COMPANY
(marked to show changes to the current Restated Articles of Incorporation)

FIRST: ~~That the~~The name of ~~said~~the Corporation is, and shall be~~ PYRAMID OIL COMPANY~~, Pyramid Oil Company.

SECOND: The purpose of ~~this~~the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

~~THIRD: THIRD: That the place where the principal business of the said corporation is to be transacted is the County of Los Angeles, State of California.~~

THIRD: ~~This~~The Corporation shall have perpetual existence.

~~FIFTH: That the number of its directors shall be seven (7).~~

FOURTH: The authorized number of directors of the Corporation shall be not less than four (4) nor more than seven (7), and the exact number of directors within those limits shall be four (4) unless and until the exact number of directors is changed from time to time, within such specified limits, by a resolution which is duly adopted by the Board of Directors of the Corporation.

FIFTH: ~~This~~The Corporation is authorized to issue two classes of stock, with no par value, designated Common Stock and Preferred Stock. The total number of shares that ~~this~~the Corporation is authorized to issue is 60,000,000. The number of shares of Common Stock that ~~this~~the Corporation is authorized to issue is 50,000,000, and the number of shares of Preferred Stock that ~~this~~the Corporation is authorized to issue is 10,000,000. The holders of the Common Stock or Preferred Stock shall have no preemptive rights to subscribe for or purchase any shares of any class of stock of ~~this~~the Corporation, whether now or hereafter authorized. The Board of Directors of ~~this~~the Corporation is authorized to: (i) determine the number of series into which shares of Preferred Stock may be divided; (ii) determine or alter the designations, rights, preferences, privileges, qualifications, limitations and restrictions granted to or imposed upon any unissued Preferred Stock or any wholly unissued series of Preferred Stock or any holders thereof; and (iii) fix the number of shares of each such series and increase or decrease, within the limits stated in any resolution of the Board of Directors originally fixing the number of shares constituting any series (but not below the number of such shares then outstanding), the number of shares of any such series subsequent to the issuance of shares of that series.

SIXTH: The ~~corporation~~Corporation elects to be governed by all of the provisions of Division 1 of Title 1 of the California Corporations Code (as amended by act of the California Legislature, 1975 976 Regular Session, effective January 1, 1977, as defined in Section 2300 of the California General Corporation Law) not otherwise applicable to this corporation under Chapter 23 of said Division 1.

~~EIGHTH: LIMITATION ON LIABILITY OF DIRECTORS AND AUTHORITY TO INDEMNIFY AGENTS~~

SEVENTH: The liability of directors of the Corporation for monetary damages shall be eliminated to the fullest extent permissible under California law. The Corporation is authorized to provide indemnification of agents (as defined in Section 317 of the California Corporations Code) through bylaw provisions, agreements with agents, vote of shareholders or disinterested directors, or otherwise, in excess of the indemnification otherwise permitted by Section 317 of the California Corporations Code, subject only to the applicable limits set forth in Section 204 of the California Corporations Code with respect to actions for breach of duty to the Corporation and its shareholders.

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APPENDIX B
PROPOSED ARTICLE II, SECTION C OF THE
AMENDED AND RESTATED BYLAWS OF PYRAMID OIL COMPANY

Section C. Number of Directors.

The authorized number of directors of the Corporation shall be not less than four (4) nor more than seven (7), and the exact number of directors within those limits shall be four (4) unless and until the exact number of directors is changed from time to time, within such specified limits, by a resolution which is duly adopted by the Board.

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PROXY PYRAMID OIL COMPANY

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS.

The undersigned shareholder of Pyramid Oil Company (the Company) hereby appoints Michael D. Herman and John H. Alexander, and each of them, the true and lawful attorneys, agents and proxies of the undersigned, with full power of substitution and revocation to each of them, for and in the name of the undersigned to vote all the shares of Common Stock of the Company which the undersigned may be entitled to vote at the Annual Meeting of Shareholders of the Company to be held at the Corporate Offices of Pyramid Oil Company, 2008 21st Street, Bakersfield, California 93301, on Thursday, June 17, 2010 at 10:30 A.M. Pacific Daylight Time, and at any postponement or adjournment of such meeting, as fully as the undersigned could do if present in person. The undersigned hereby revokes all proxies heretofore given.

THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED SHAREHOLDER. IF NO VOTING INSTRUCTIONS ARE GIVEN, THIS PROXY WILL BE VOTED FOR: (1) APPROVAL OF THE AMENDMENT OF THE COMPANY S RESTATED ARTICLES OF INCORPORATION AND AMENDED AND RESTATED BYLAWS DESCRIBED IN THE PROXY STATEMENT; (2) APPROVAL OF THE ELECTION OF THE NOMINEES FOR DIRECTORS NAMED HEREIN; AND (3) THE RATIFICATION OF THE COMPANY S SELECTION OF SINGERLEWAK LLP AS THE COMPANY S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2010 IN THEIR DISCRETION, THE PROXIES ARE AUTHORIZED TO VOTE UPON SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE MEETING AND AT ANY AND ALL ADJOURNMENTS OF THE MEETING.

THIS PROXY MAY BE REVOKED AT ANY TIME BEFORE IT IS VOTED AT THE MEETING.

PLEASE SIGN AND RETURN PROMPTLY.

ANNUAL MEETING PROXY CARD

A Proposals The Board of Directors recommends a vote FOR all the nominees under Proposal 2 and FOR Proposals 1 and 3.

1. To approve an amendment to the Company s Restated Articles of Incorporation and Amended and Restated Bylaws to change the authorized number of directors from a fixed number of seven to a minimum number of four and a maximum number of seven directors, with the initial number of authorized directors to be four, and to delete references in the Restated Articles of Incorporation to the Company s principal place of business.

For	Against	Abstain
[ ]	[ ]	[ ]

2. Election of Directors for a Term of One Year

	For	Against	Abstain
01 Michael D. Herman	[ ]	[ ]	[ ]
02 John H. Alexander	[ ]	[ ]	[ ]
03 Gary L. Ronning	[ ]	[ ]	[ ]
04 John E. Turco	[ ]	[ ]	[ ]

	For	Against	Abstain
3. To ratify the selection of SingerLewak, LLP as the Company s independent registered public accounting firm for 2010.	[ ]	[ ]	[ ]

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B Non-Voting Items

Change of Address Please print new address below**.**

C Authorized Signatures This section must be completed for your vote to be counted. Date and Sign Below

Please sign exactly as name(s) appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, corporate officer, trustee, guardian, or custodian, please give full title.

Date	Signature 1	Signature 2

="2"> On March 1, 2001, after concluding that Pharmacia Corporation planned to file a patent infringement lawsuit against the Company regarding the glaucoma drug *Lumigan*®, the Company filed a declaratory relief lawsuit against Pharmacia (and related entities) in the United States District Court for the District of Delaware. In the lawsuit, the Company asked the court to issue a ruling that *Lumigan*® does not infringe certain patents owned or controlled by Pharmacia and also that such patents are not valid. On March 21, 2001, Pharmacia filed an answer to the complaint, denying Allergan s allegations. Pharmacia and Columbia University also filed a counterclaim against Allergan, alleging that Allergan infringes the same two patents that Allergan identified in its complaint. On April 10, 2001, Allergan filed its answer to the counterclaim of Pharmacia and Columbia, as well as a counterclaim in reply against Columbia. Trial is currently scheduled to begin on October 21, 2002. See Certain Factors and Trends Affecting Allergan and its Businesses for further information about the risks and uncertainties associated with patents.

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

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

On or about January 8, 2002, after receiving paragraph 4 invalidity and noninfringement Hatch-Waxman Act certifications from Bausch & Lomb and Alcon Laboratories indicating that both had filed ANDAs for a generic form of *Alphagan*®, Allergan filed a patent infringement lawsuit against Bausch & Lomb and Alcon Laboratories in the Central District of California. In the complaint, Allergan asked the Court to find that the *Alphagan*® patents at issue are valid and infringed by the drug products sought to be approved in the Bausch & Lomb and Alcon ANDAs.

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

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

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

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

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

David E.I. Pyott	48	Chairman of the Board, President and Chief Executive Officer

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PART II

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

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

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

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

The approximate number of stockholders of record was 7,500 as of January 31, 2002.

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

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Item 6. Selected Financial Data

	Year Ended December 31,				
(in millions, except per share data)	2001	2000	1999	1998	1997
Summary of Operations					
Product net sales	$1,685.2	$1,562.6	$1,406.2	$1,261.7	$1,138.0

Research service revenues, primarily from a related party (through April 16, 2001)
60.3 62.9 46.2 34.4 11.0
Operating costs and expenses:

Cost of product sales
410.2 429.1 406.4 407.0 399.3
Cost of research services
56.1 59.4 43.3 32.1 10.4
Selling, general and administrative
704.0 650.1 587.9 525.2 459.1
Technology fees from related party
(0.7) (3.1) (6.1) (11.2)
Research and development
256.5 195.6 168.4 125.4 131.2
Restructuring charge (reversal)
(1.7) (2.0) (9.6) 74.8
Asset write-offs (reversal)
(1.4) 58.5
Contribution to Allergan Specialty Therapeutics, Inc.
171.4

Operating income (loss)
321.1 296.4 263.5 (87.1) 149.0
Non-operating income
15.3 7.4 5.5 29.4 8.1
Earnings (loss) before income taxes and minority interest
336.4 303.8 269.0 (57.7) 157.1
Net earnings (loss)
224.9 215.1 188.2 (90.2) 128.3
Basic earnings (loss) per common share
1.71 1.65 1.42 (0.69) 0.98
Diluted earnings (loss) per common share
1.68 1.61 1.39 (0.69) 0.97
Cash dividends per share
0.36 0.32 0.28 0.26 0.26
Financial Position

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

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

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

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

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

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

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

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

In each region, the Company markets products in two product lines: Specialty Pharmaceuticals and Optical Medical Devices. The Specialty Pharmaceutical line produces a broad range of ophthalmic products for glaucoma therapy, ocular inflammation, infection, allergy and dry eye; skin care products for acne, psoriasis and other prescription and over the counter dermatological products; and *Botox*® (Botulinum toxin type A) for therapeutic neuromuscular disorders and related pain as well as cosmetic facial aesthetics. The Optical Medical Devices product line consists of the Ophthalmic Surgical and Contact Lens Care businesses. The Ophthalmic Surgical line produces intraocular lenses, phacoemulsification equipment, viscoelastics, and other products related to cataract surgery. The Contact Lens Care line produces cleaning, storage and disinfection products for the consumer contact lens market. The Company provides global marketing strategy teams to ensure development and execution of a consistent marketing strategy for products in all geographic operating segments.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Subsequent Event Discontinued Operations

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

Results Of Operations

Net Sales

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

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

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

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

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

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

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

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

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

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

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

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

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

Income and Expenses

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

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

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

Gross Margin

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

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Selling, General and Administrative

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

Research and Development

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

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

Special Charges

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

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

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

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

	Payments to Employees Involuntarily Terminated	Facility Closure and Consolidation Costs	Abandonment of Computer Software Costs	Other Costs	Total Restructuring
Net charge during 1998	$ 22.7	$ 28.9	$ 10.6	$ 12.6	$ 74.8

Assets written off during 1998
(25.3) (10.6) (4.8) (40.7)
Spending during 1998
(3.6) (7.4) (11.0)

Balances as of December 31, 1998
19.1 3.6 0.4 23.1
Adjustments during 1999
(0.3) 0.3
Net credit during 1999
(2.6) (0.7) (0.5) (3.8)
Assets written off during 1999
(0.3) (0.3)
Spending during 1999
(8.5) (0.4) (8.9)

Balances as of December 31, 1999
8.0 1.9 0.2 10.1
Adjustments during 2000
(0.5) 0.4 0.1
Spending during 2000
(4.0) (0.1) (4.1)

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

Balances as of December 31, 2001
$ $ $ $ $

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

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

Operating Income

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

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

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

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The following table presents operating income by geographic operating segment:

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

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

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

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

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

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

Income Taxes

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

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

Net Earnings

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

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

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Liquidity And Capital Resources

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

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

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

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

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

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

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

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

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

Capital Expenditures

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

Inflation

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

Foreign Currency Fluctuations

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

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

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

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Bardeen Sciences Company, LLC

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

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

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

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

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

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

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

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

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

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

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

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

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

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

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

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

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

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

Interest Rate Risk

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

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

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

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

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

DECEMBER 31, 2001

(in millions, except interest rates)	2002	2003	Maturing in 2004	2005	2006	Thereafter	Total	Fair Market Value

ASSETS

Cash equivalents:

Repurchase Agreements
$182.9 $182.9 ***$182.9***
Weighted Average Interest Rate
2.16% 2.16%
Foreign Time Deposits
51.9 51.9 ***51.9***
Weighted Average Interest Rate
3.93% 3.93%
Commercial Paper
386.3 386.3 ***386.3***
Weighted Average Interest Rate
1.91% 1.91%
Other Cash Equivalents
105.2 105.2 ***105.2***
Weighted Average Interest Rate
2.23% 2.23%
Total cash equivalents
$726.3 $726.3 $726.3
Weighted Average Interest Rate
2.16% 2.16%

LIABILITIES

Debt Obligations:

Fixed Rate ($US)
$20.0 $30.0 $411.8 $461.8 ***$461.2***
Weighted Average Interest Rate
6.92% 5.72% 2.50% 2.90%
Fixed Rate (JPY)
19.0 $37.8 56.8 ***59.1***
Weighted Average Interest Rate
3.55% 1.85% 2.42%
Other Fixed Rate (non-US$)
4.2 0.4 $0.1 4.7 ***4.7***
Weighted Average Interest Rate
16.85% 12.85% 12.00% 16.41%
Variable Rate ($US)
29.7 1.4 31.1 ***31.1***
Weighted Average Interest Rate
3.41% 1.93% 3.34%
Variable Rate (JPY)
19.0 19.0 38.0 ***38.0***
Weighted Average Interest Rate
0.75% 0.58% 0.67%

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

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DECEMBER 31, 2000

(in millions, except interest rates)	2001	2002	Maturing in 2003	2004	2005	Thereafter	Total	Fair Market Value
ASSETS								
Cash equivalents:								
Repurchase Agreements	$350.0						$350.0	$350.0
Weighted Average Interest Rate	6.76%						6.76%	
Commercial Paper	257.3						257.3	257.3
Weighted Average Interest Rate	6.58%						6.58%	
Foreign Time Deposits	48.3						48.3	48.3
Weighted Average Interest Rate	5.38%						5.38%	
Total cash equivalents	***$655.6***						***$655.6***	***$655.6***
Weighted Average Interest Rate	***6.59%***						***6.59%***	
LIABILITIES								
Debt Obligations:								
Fixed Rate ($US)	$14.0	$45.0	$30.0			$401.7	$490.7	$546.2
Weighted Average Interest Rate	6.83%	7.21%	5.72%			2.50%	3.25%	
Fixed Rate (JPY)			21.9		$43.5		65.4	67.4
Weighted Average Interest Rate			3.55%		1.85%		2.42%	
Other Fixed Rate (non-US$)	0.9	0.9	0.3				2.1	2.1
Weighted Average Interest Rate	13.5%	13.5%	13.5%				13.5%	
Variable Rate ($US)	3.2	3.0	1.6				7.8	7.8
Weighted Average Interest Rate	5.89%	5.75%	5.75%				5.81%	
Variable Rate (JPY)	17.5	13.1	21.9				52.5	52.5
Weighted Average Interest Rate	1.20%	1.23%	1.10%				1.17%	
Other Variable Rate (non US$)	23.6	0.7	0.6	$0.5			25.4	25.4
Weighted Average Interest Rate	8.53%	5.10%%	5.10%	5.10%			8.29%	
Total Debt Obligations	***$59.2***	***$62.7***	***$76.3***	***$0.5***	***$43.5***	***$401.7***	***$643.9***	***$701.4***
Weighted Average Interest Rate	***5.89%***	***5.96%***	***3.80%***	***5.10%***	***1.85%***	***2.50%***	***3.26%***	

INTEREST RATE DERIVATIVES
Interest Rate Swaps

Variable to Fixed		
$39.4	$39.4	$(0.1)
Average Pay Rate		
0.86%	0.86%	
Average Receive Rate		
0.55%	0.55%	

Foreign Currency Risk

Overall, the Company is a net recipient of currencies other than the U.S. dollar and, as such, benefits from a weaker dollar and is 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 the Company s consolidated sales and gross margins as expressed in U.S. dollars.

From time to time, the Company enters into foreign currency option and foreign currency forward contracts to reduce earnings and cash flow volatility associated with foreign exchange rate changes to allow management to focus its attention on its core business issues and challenges. Accordingly, the Company enters 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. The Company enters into foreign currency option and foreign currency forward contracts in amounts between minimum and maximum anticipated foreign exchange exposures, generally for

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periods not to exceed one year. The realized gains and losses on these contracts upon settlement of the contracts economically offset changes in the value of the related exposures and are recorded in Other, net in the accompanying Consolidated Statements of Earnings.

All of the Company s 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. Upon adoption of SFAS No. 133, the Company s management decided not to designate the foreign currency forward contracts as accounting hedges. Accordingly, changes in the fair value of the foreign currency forward contracts and the revaluation of the foreign currency denominated intercompany receivables are recorded through Other, net in the accompanying Consolidated Statements of Earnings.

Probable but not firmly committed transactions are comprised of sales of the Company s products and purchases of raw materials in currencies other than the U.S. dollar. A majority of these sales are made through the Company s subsidiaries in Europe, Asia (particularly Japan), Canada and Australia. The Company purchases foreign exchange option contracts to economically hedge the currency exchange risks associated with these probable but not firmly committed transactions. The duration of foreign exchange hedging instruments, whether for firmly committed transactions or for probable but not firmly committed transactions, currently does not exceed one year. The premium cost of purchased foreign exchange option contracts are recorded in Other Current Assets and amortized over the life of the options.

A substantial portion of the Company s purchased options are entered into to protect the value of anticipated, but not firmly committed transactions in Japan, Europe, Australia and Canada. Upon adoption of SFAS No. 133, the Company s management decided not to designate the foreign currency option contracts as accounting hedges. Accordingly, current changes in the fair value of the foreign currency option contracts are recorded through earnings as Unrealized Gains/Losses on Derivative Instruments in the accompanying Consolidated Statements of Earnings.

The following table provides information about the Company s foreign currency derivative financial instruments outstanding as of December 31. The information is provided in U.S. dollar amounts, as presented in the Company s Consolidated Financial Statements.

	2001		2000	
	Notional Amount (in millions)	Average Contract Rate or Strike Amount	Notional Amount (in millions)	Average Contract Rate or Strike Amount
Foreign currency forward contracts: (Receive $US/Pay Foreign Currency)				

Euros
$19.6 0.90 $
Australian Dollars
2.3 0.51 3.7 0.54
Spanish Pesetas
7.4 188.80
French Francs
8.7 7.44
Italian Lira
4.1 2,196.98
Miscellaneous other currencies
0.1 n/a 1.1 n/a

22.0 25.0

Estimated fair value		
	$0.2	$(1.5)

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	2001		2000	
	Notional Amount (in millions)	Average Contract Rate or Strike Amount	Notional Amount (in millions)	Average Contract Rate or Strike Amount
Foreign currency purchased put options:				
Japanese Yen	$57.2	118.78	$36.8	105.92
Euro	62.0	0.90	71.2	0.87
Canadian Dollar	12.0	1.57	13.4	1.53
Australian Dollar	7.1	0.51	3.9	0.54
Brazilian Real			4.5	2.83
U.K. Pound	3.4	1.44	7.6	1.46
Other	11.9	n/a	11.9	n/a
	$158.1		$144.8	
Estimated fair value	$9.2		$3.7	

New Accounting Standards Not Yet Adopted

In July 2001, Statement of Financial Accounting Standards No. 141, Business Combinations, (SFAS No. 141) was issued. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method combinations completed after June 30, 2001. SFAS No. 141 also requires that the Company evaluate its existing intangible assets and goodwill that were acquired in prior business combinations, and to make any necessary reclassifications in order to conform with the new criteria in SFAS No. 141 for recognition of intangibles apart from goodwill.

Additionally, in July 2001, Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142) was issued and is effective for all periods of fiscal years beginning after December 15, 2001 (January 1, 2002 for the Company). SFAS No. 142 establishes accounting and reporting standards for intangible assets. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives be evaluated annually for impairment rather than amortized. Upon adoption of SFAS No. 142, the Company will also be required to test goodwill and intangible assets with indefinite useful lives for impairment within the first interim period with any impairment loss being recognized as a cumulative effect of a change in accounting principle.

In connection with the transitional goodwill impairment evaluation, SFAS No. 142 requires the Company to perform an assessment of whether there is an indication that goodwill and intangible assets with indefinite useful lives are impaired as of the date of adoption. To accomplish this the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company then has up to

six months from the date of adoption to determine the fair value of each reporting unit and compare it to the reporting unit s carrying amount. To the extent a reporting unit s carrying amount exceeds its fair value, an indication exists that the reporting unit s goodwill may be impaired.

The Company adopted the provisions of SFAS No. 141 and SFAS No. 142 on January 1, 2002 which did not result in a negative impact on the Company s Consolidated Financial Statements. As of January 1, 2002, the Company had unamortized goodwill in the amount of $109.8 million, which will be subject to the transition provisions of SFAS No. 141 and SFAS No. 142. Amortization expense related to goodwill was $11.8 million, $12.5 million, and $13.8 million for the years ended December 31, 2001, 2000 and 1999, respectively. The AMO portion of this amortization expense was $9.0 million, $9.3 million and $9.2 million for the years ended December 31, 2001, 2000 and 1999, respectively.

In October 2001, Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144) was issued. SFAS No. 144 supersedes Statement No. 121,

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Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations Reporting the effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business. SFAS No. 144 retains the requirement in Opinion No. 30 to report separately discontinued operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. The Company is required and plans to adopt the provisions of SFAS No. 144 in the quarter ending March 29, 2002. The implementation of SFAS No. 144 will not have a material effect on the Company s financial statements.

Forward Looking Statements

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

Certain disclosures made by the Company in this report and in other reports and statements released by the Company are and will be forward-looking in nature, such as comments which express the Company s opinions about trends and factors which may impact future operating results. Disclosures that use words such as the Company believes, anticipates, expects and similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from expectations. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in context with the Company s disclosures about its businesses made in the Company s press releases and in the Company s Annual Report on Form 10-K and other reports filed with the Securities and Exchange Commission.

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Item 8. Financial Statements And Supplementary Data

CONSOLIDATED BALANCE SHEETS

	As of December 31,	
	2001	2000
	In millions, except share data	
ASSETS		
Current assets		
Cash and equivalents	$781.9	$773.9
Trade receivables, net	279.4	290.1
Inventories	120.2	122.7
Other current assets	143.8	139.6
Total current assets	1,325.3	1,326.3
Investments and other assets	205.3	159.9
Property, plant and equipment, net	388.7	351.6
Goodwill and intangibles, net	126.9	133.2
Total assets	$2,046.2	$1,971.0

LIABILITIES AND STOCKHOLDERS EQUITY

Current liabilities		
Notes payable	$94.1	$59.2
Accounts payable	104.3	96.3
Accrued compensation	62.5	54.6
Other accrued expenses	114.7	123.9
Income taxes	114.4	98.5
Total current liabilities	490.0	432.5
Long-term debt	108.8	183.0
Long-term convertible subordinated notes, net of discount	411.8	401.7
Other liabilities	57.0	79.4
Commitments and contingencies		
Minority interest	1.2	0.6
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 134,255,000 shares	1.3	1.3
Additional paid-in capital	321.6	288.7
Accumulated other comprehensive loss	(61.6)	(50.8)
Retained earnings	928.4	780.0
	1,189.7	1,019.2
Less treasury stock, at cost (3,005,000 and 2,574,000		

shares)	(212.3)	(145.4)
Total stockholders equity	977.4	873.8
Total liabilities and stockholders equity	$2,046.2	$1,971.0

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF EARNINGS

	Year Ended December 31,		
	2001	2000	1999
	In millions, except per share data		
Product sales			
Net sales	$1,685.2	$1,562.6	$1,406.2
Cost of sales	410.2	429.1	406.4
Product gross margin	1,275.0	1,133.5	999.8
Research services			
Research service revenues (primarily from related party through April 16, 2001)	60.3	62.9	46.2
Cost of research services	56.1	59.4	43.3
Research services margin	4.2	3.5	2.9

Selling, general and administrative	704.0	650.1	587.9
Research and development	256.5	195.6	168.4
Technology fees from related party	(0.7)	(3.1)	(6.1)
Restructuring charge reversal	(1.7)	(2.0)	(9.6)
Asset write-off reversal			(1.4)
Operating income	321.1	296.4	263.5
Interest income	30.6	23.9	14.3
Interest expense	(21.4)	(19.8)	(15.1)
(Loss)/gain on investments, net	(5.2)	1.0	14.0
Unrealized gains on derivative instruments	5.9		
Contributions to the Allergan Foundation			(6.9)
Other, net	5.4	2.3	(0.8)
Earnings before income taxes and minority interest	336.4	303.8	269.0
Provision for income taxes	109.1	88.1	80.7
Minority interest	0.6	0.6	0.1

Earnings before cumulative effect of change in accounting principle	226.7	215.1	188.2
Cumulative effect of change in accounting principle, net of $0.7 million of tax	(1.8)		
Net earnings	$224.9	$215.1	$188.2
Basic:			
Before cumulative effect of change in accounting principle	$1.72	$1.65	$1.42
Cumulative effect of accounting change, net	(0.01)		
Net basic earnings per common share	$1.71	$1.65	$1.42
Diluted:			
Before cumulative effect of change in accounting principle	$1.69	$1.61	$1.39

Cumulative effect of accounting change, net	(0.01)		
Net diluted earnings per common share	$1.68	$1.61	$1.39

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

in millions	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Unearned Compensation	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Total	Comprehensive Income
Balance December 31, 1998	67.1	$0.7	$239.3	$(16.3)	$(4.3)	$516.3	(1.0)	$(39.7)	$696.0	

Comprehensive income

Net earnings
188.2 188.2 188.2
Other comprehensive income, net of tax:

Foreign currency translation Adjustments
(42.1)
Unrealized loss on Investments
(2.9)

Other comprehensive loss
(45.0) (45.0) (45.0)

Comprehensive income
$143.2

Two for one stock split affected as a dividend
67.2 0.6 (0.6) (1.0)
Dividends ($0.28 per share)
(37.0) (37.0)
Stock options exercised
22.2 (17.8) 1.0 46.6 51.0
Activity under other stock plans
(0.1) (5.4) 4.5 1.3 4.3 3.3
Adjustment in reporting of Subsidiaries
(2.5) (2.5)
Purchase of treasury stock
(4.7) (225.3) (225.3)
Expense of compensation plans
5.8 5.8

Balance December 31, 1999
134.3 1.3 261.4 (15.9) (49.3) 651.1 (4.4) (214.1) 634.5
Comprehensive income

Net earnings
215.1 215.1 215.1
Other comprehensive income, net of tax:

Foreign currency translation Adjustments
(2.8)
Unrealized gain on Investments
1.3

Other comprehensive loss
(1.5) (1.5) (1.5)

Comprehensive income
$213.6

Dividends ($0.32 per share)
(41.9) (41.9)
Stock options exercised
37.1 (41.8) 3.9 189.9 185.2
Activity under other stock plans
0.4 0.7 1.6 2.7
Adjustment in reporting of Subsidiaries
(3.2) (3.2)
Purchase of treasury stock
(2.1) (122.8) (122.8)
Expense of compensation plans
5.7 5.7

Balance December 31, 2000
134.3 1.3 298.5 (9.8) (50.8) 780.0 (2.6) (145.4) 873.8
Comprehensive income

Net earnings
224.9 224.9 224.9
Other comprehensive income, net of tax:

Minimum pension liability Adjustment
(7.2)
Foreign currency translation Adjustments
(2.5)
Unrealized loss on Investments
(1.1)

Other comprehensive loss
(10.8) (10.8) (10.8)

Comprehensive income
$214.1

Dividends ($0.36 per share)
(47.5) (47.5)
Stock options exercised
26.5 (30.9) 1.3 61.8 57.4
Activity under other stock plans
0.5 1.9 0.1 2.2 4.6
Purchase of treasury stock
(1.8) (130.9) (130.9)
Expense of compensation plans
5.9 5.9

Balance December 31, 2001

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134.3	$1.3	$325.0	$(3.4)	$(61.6)	$928.4	(3.0)	$(212.3)	$977.4

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

In millions	Year Ended December 31, 2001	2000	1999

Cash flows provided by operating activities

Net earnings
$224.9 $215.1 $188.2

Non cash items included in net earnings:

Cumulative effect of accounting change for derivative instruments
2.5

In-process research and development
40.0

Depreciation and amortization
75.0 77.7 73.8

Amortization of prepaid royalties
0.4 7.4 8.6

Amortization of original issue discount
10.1 1.7

Deferred income taxes (benefit)
10.9 (4.6) (7.1)

(Gain) loss on investments
5.2 (1.0) (14.0)

Loss (gain) on sale of assets
1.2 1.1 (0.2)

Unrealized gain on derivatives
(5.9)

Gain on divestiture of pharmaceutical products
(2.0)

Contribution to The Allergan Foundation
6.9

Expense of compensation plans
11.6 8.5 10.0

Minority interest
0.6 0.6 0.1

Restructuring charge reversal
(1.7) (2.0) (9.6)

Asset write-off reversal
(1.4)

Adjustment in reporting of foreign subsidiaries
(3.2) (2.5)

Changes in assets and liabilities:

Trade receivables
0.3 (48.8) (31.8)

Inventories
(1.9) 4.6 (6.9)

Accounts payable
8.3 15.9 11.2

Accrued expenses	(15.5)	24.2	(27.9)
Income taxes	*42.7*	*52.0*	*66.3*
Other	(45.5)	4.9	(9.4)
Net cash provided by operating activities	361.2	354.1	254.3
Cash flows from investing activities			
Additions to property, plant and equipment	(89.9)	(66.9)	(63.3)
Proceeds from sale of property, plant and equipment	5.2	1.1	13.7
Proceeds from sale of investments		3.0	33.8
Acquisition, net of cash acquired	(70.2)		
Other, net	(21.9)	(22.5)	(37.2)
Net cash used in investing activities	(176.8)	(85.3)	(53.0)
Cash flows from financing activities			

Dividends to stockholders	(47.5)	(41.9)	(37.0)
(Decrease) increase in notes payable	(19.9)	(29.1)	0.6
Sale of stock to employees	30.9	148.1	28.8
Net (repayments) borrowings under commercial paper obligations		(47.1)	4.5
Proceeds from convertible, subordinated borrowings		400.0	
Long-term debt borrowings		43.8	17.7
Repayments of long-term debt	(3.2)	(5.2)	(2.7)
Payments to acquire treasury stock	(130.9)	(122.8)	(225.3)
Net cash (used in) provided by financing activities	(170.6)	345.8	(213.4)
Effect of exchange rates on cash and equivalents	(5.8)	(3.6)	(6.6)
Net increase (decrease) in cash and equivalents	8.0	611.0	(18.7)
Cash and equivalents at beginning of year	773.9	162.9	181.6
Cash and equivalents at end of year	$781.9	$773.9	$162.9

Supplemental disclosure of cash flow information

Cash paid during the year for:

Interest (net of amount capitalized)	$20.9	$19.2	$13.4
Income taxes	$52.2	$54.5	$33.2

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of Allergan, Inc. and all of its subsidiaries. All significant transactions among the consolidated entities have been eliminated from the financial statements.

During the fiscal years between 1997 and 1999, the Company converted the financial systems of its significant non-U.S. subsidiaries. Simultaneous with the system conversion, the Company modified the results of operations to be accounted for on a calendar year basis rather than on the fiscal year ended November 30. All significant non-U.S. subsidiaries completed this conversion by December 31, 1999. For the year ended December 31, 1999 approximately $19.2 million in revenue and $2.5 million of net losses were recorded in the month of activity not included in operating results. Activities not included in operating results were recorded as adjustments to retained earnings. While there were no such conversions in 2000, miscellaneous adjustments were made during 2000 to activities previously recorded to retained earnings.

Use of Estimates

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts based on informed estimates and judgments of management. Actual results could differ from those estimates.

Foreign Currency Translation

The financial position and results of operations of the Company s foreign subsidiaries are generally determined using local currency as the functional currency. Assets and liabilities of these subsidiaries are translated at the exchange rate in effect at each year-end. Income statement accounts are translated at the average rate of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in accumulated other comprehensive income in stockholders equity. Gains and losses resulting from foreign currency transactions and translation adjustments relating to foreign entities deemed to be operating in U.S. dollar functional currency in highly inflationary economies are included in earnings.

Cash and Equivalents

The Company considers cash and equivalents to include cash in banks, repurchase agreements, commercial paper and deposits with financial institutions which can be liquidated without prior notice or penalty.

Investments

The Company has both marketable and non-marketable equity investments in conjunction with its various collaboration arrangements. The Company classifies its marketable equity investments as available-for-sale securities with net unrealized gains or loss recorded as a component of accumulated other comprehensive loss. The non-marketable equity investments represent investments in start-up technology companies or partnerships that invest in start-up technology companies and are recorded at cost and are evaluated periodically for impairment. If it is determined that a decline of any investment is other than temporary, then the investment basis would be written down to fair value and the write-down would be included in earnings as a loss.

Inventories

Inventories are valued at the lower of cost or market (net realizable value). Cost is determined by the first-in, first-out method.

Long-Lived Assets

Property, plant and equipment are stated at cost. Additions, major renewals and improvements are capitalized, while maintenance and repairs are expensed. Upon disposition, the net book value of assets is relieved and resulting gains or losses are reflected in earnings. For financial reporting purposes, depreciation is generally provided on the straight-line method over the useful life of the related asset. Accelerated depreciation methods are generally used for income tax purposes.

Goodwill represents the excess of acquisition costs over the fair value of net assets of purchased businesses and was amortized on a straight-line basis over periods from 7 to 30 years for the years ended December 31, 2001, 2000 and 1999. Intangibles include patents, licensing agreements and marketing rights which are being amortized over their estimated useful lives ranging from 3 to 10 years. Amortization expense for goodwill and all other intangibles was $13.1 million in 2001, $14.5 million in 2000, and $17.6 million in 1999.

Long-lived assets are reviewed for impairment in value when changes in circumstances dictate based upon undiscounted future operating cash flows, and appropriate losses are recognized and reflected in current earnings, to the extent the carrying amount of an asset exceeds its estimated fair value determined by the use of appraisals, discounted cash flow analyses or comparable fair values of similar assets.

Revenue Recognition

The Company recognizes revenue from product sales, except for intraocular lenses, when the goods are shipped to the customer. The Company generally permits returns of product from any product line by any class of customer if such product is returned in a timely manner, in good condition, from the normal channels of distribution. Return policies in certain international markets provide for more stringent guidelines for returns in accordance with the terms of contractual agreements with customers. Allowances for returns are provided for based upon an analysis of the Company s historical patterns of returns matched against the sales from which they originated. Historical product returns have been within the amounts reserved. Intraocular lenses are generally sold on a consignment basis and are, therefore, generally not subject to return. Revenue is recognized on the ultimate sales of intraocular lenses.

Research service revenue is recognized and related costs are recorded as services are performed under research service agreements. At such time, the research service customers are obligated to pay, and such obligation is not refundable.

The Company recognizes as other income license fees based upon the facts and circumstances of each licensing agreement. In general, the Company recognizes income on signing of a license agreement that grants rights to products or technology to a third party if the Company has no further obligation to provide products or services to the third party after granting the license.

Stock-Based Compensation

The Company measures stock based compensation for option grants to employees and members of the board of directors using a method which assumes that options granted at market price at the date of grant have no intrinsic value. Pro forma net earnings and earnings per share are presented in Note 13 as if the fair value method had been applied.

Income Taxes

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, if it is more likely than not that the tax benefits will be realized. To the extent a deferred tax asset cannot be recognized under the preceding criteria, allowances must be established. The impact on deferred taxes of changes in tax rates and laws, if any, are applied to the years during which temporary differences are expected to

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be settled and reflected in the financial statements in the period of enactment. No provision is made for taxes on unremitted earnings of certain non-U.S. subsidiaries which are or will be reinvested indefinitely in such operations.

Comprehensive Income

Comprehensive income encompasses all changes in equity other than those with stockholders and consists of net earnings, foreign currency translation adjustments, minimum pension liability adjustments and unrealized gains or losses on marketable equity investments. The Company does not provide for U.S. income taxes on foreign currency translation adjustments since it does not provide for such taxes on undistributed earnings of foreign subsidiaries.

Reclassifications

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

Recently Adopted Accounting Standards

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

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

New Accounting Standards Not Yet Adopted

In July 2001, Statement of Financial Accounting Standards No. 141, Business Combinations, (SFAS No. 141) was issued. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method combinations completed after June 30, 2001. SFAS No. 141 also requires that the Company evaluate its existing intangible assets and goodwill that were acquired in prior business combinations, and to make any necessary reclassifications in order to conform with the new criteria in SFAS No. 141 for recognition of intangibles apart from goodwill.

Additionally, in July 2001, Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142) was issued and is effective for all periods of fiscal years beginning after December 15, 2001 (January 1, 2002 for the Company). SFAS No. 142 establishes accounting and reporting standards for intangible assets. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives be evaluated annually for impairment rather than amortized. Upon adoption of SFAS No. 142, the Company will also be required to test goodwill and intangible assets with indefinite useful lives for impairment within the first interim period with any impairment loss being recognized as a cumulative effect of a change in accounting principle.

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In connection with the transitional goodwill impairment evaluation, SFAS No. 142 requires the Company to perform an assessment of whether there is an indication that goodwill and intangible assets with indefinite useful lives are impaired as of the date of adoption. To accomplish this the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company then has up to six months from the date of adoption to determine the fair value of each reporting unit and compare it to the reporting unit s carrying amount. To the extent a reporting unit s carrying amount exceeds its fair value, an indication exists that the reporting unit s goodwill may be impaired.

The Company adopted the provisions of SFAS No. 141 and SFAS No. 142 on January 1, 2002 which did not result in a negative impact on the Company s Consolidated Financial Statements. As of January 1, 2002, the Company had unamortized goodwill in the amount of $109.8 million, which will be subject to the transition provisions of SFAS No. 141 and SFAS No. 142. Amortization expense related to goodwill was $11.8 million, $12.5 million, and $13.8 million for the years ended December 31, 2001, 2000 and 1999, respectively. The Advanced Medical Optics, Inc. portion (as fully described in Note 2), of this amortization expense was $9.0 million, $9.3 million and $9.2 million for the years ended December 31, 2001, 2000 and 1999, respectively.

In October 2001, Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144) was issued. SFAS No. 144 supersedes Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations Reporting the effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business. SFAS No. 144 retains the requirement in Opinion No. 30 to report separately discontinued operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. The Company is required and plans to adopt the provisions of SFAS No. 144 for the quarter ending March 29, 2002. The implementation of SFAS No. 144 will not have a material effect on the Company s financial statements.

Note 2: Subsequent Events

On January 18, 2002, the Board of Directors declared a cash dividend of $.09 per share payable on March 14, 2002 to stockholders of record on February 15, 2002.

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

Subsequent to the spin-off of AMO, the Company expects to reflect AMO as a discontinued operation in accordance with SFAS No. 144.

As the Company does not account for its AMO business on the basis of separate legal entities, the below financial information summarizes the assets, liabilities, revenues and gross margin directly attributable to AMO s operations. The AMO financial information includes allocations of certain Allergan corporate assets, liabilities and expenses to AMO. These amounts have been allocated to AMO on the basis that is considered by management to reflect most fairly or reasonably the utilization of these services provided to or the benefit obtained by AMO. Management believes the methods used to allocate these amounts are reasonable. However, the financial

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information included below does not purport to be indicative of the results of AMO or Allergan, Inc. without AMO in the future or what financial position or results of operations would have been had AMO and Allergan, Inc. without AMO been separate stand alone entities during the periods presented.

Below is a summary of certain financial information for the Company, AMO and the Company without AMO :

	2001		
(in millions)	Allergan, Inc.	AMO	Allergan, Inc. without AMO