ALLERGAN INC
Form 10-Q
November 01, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 24, 2004

OR

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

COMMISSION FILE NUMBER 1-10269

ALLERGAN, INC.

(Exact name of Registrant as Specified in its Charter)

DELAWARE (State or Other Jurisdiction of Incorporation or Organization)	95-1622442 (I.R.S. Employer Identification No.)
2525 DUPONT DRIVE, IRVINE, CALIFORNIA (Address of Principal Executive Offices)	92612 (Zip Code)

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

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

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

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

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

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

INDEX

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Allergan, Inc.

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

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

Allergan, Inc.

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

Allergan, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows
(in millions)

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

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

Reclassifications

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

Stock-Based Compensation

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

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

2. Recently Adopted Accounting Standards

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

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

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

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

3. Intangibles and Goodwill

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

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

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

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

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

Goodwill

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

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

4. Inventories

Components of inventories were:

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

5. Income Taxes

Income taxes are determined using an estimated annual effective tax rate, which is generally less than the U.S. Federal statutory rate, primarily because of lower tax rates in certain non-U.S. jurisdictions and research and development (R&D) tax credits available in the United States. The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities, along with net operating loss and credit carryforwards. The Company records a valuation allowance against its deferred tax assets to reduce the net carrying value to an amount that it believes is more likely than not to be realized. When the Company establishes or reduces the valuation allowance against its deferred tax assets, its income tax expense will increase or decrease, respectively, in the period such determination is made. Included in the provision for income taxes for the nine months ended September 24, 2004 is an estimated $6.1 million income tax benefit for previously paid state income taxes, which became recoverable due to a favorable state court decision that became final during the second quarter of 2004.

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

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

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

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

6. Employee Retirement and Other Benefit Plans

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

Allergan, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

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

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

	Nine months ended	
(in millions)	Pension Benefits	Other Postretirement