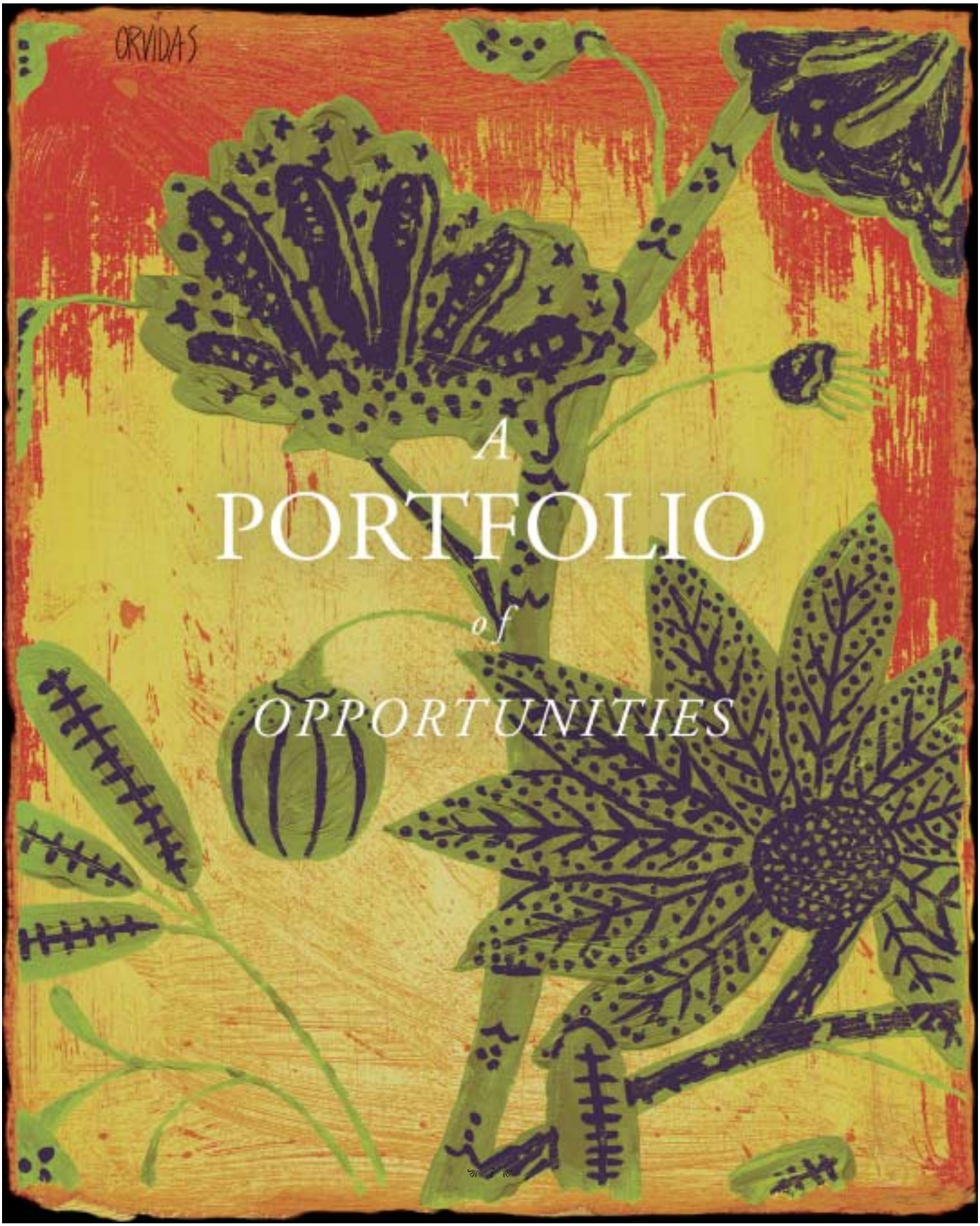
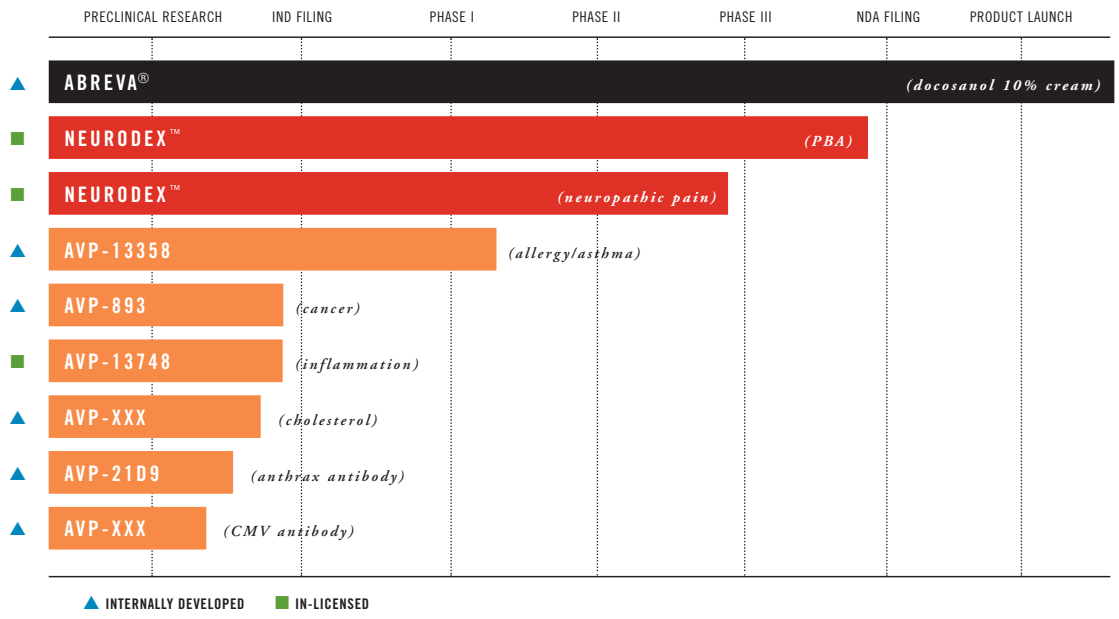
AVANIR pharmaceuticals



Contents

DEVELOPMENT PIPELINE

MIDWAY THROUGH THE YEAR 2000, AFTER SUCCESSFULLY PARTNERING ITS FIRST PRODUCT AND SECURING FDA APPROVAL, AVANIR BEGAN TO ASSEMBLE ITS PRODUCT DEVELOPMENT PORTFOLIO THROUGH AN AGGRESSIVE PROGRAM OF IN-LICENSING AND IN-HOUSE DRUG DISCOVERY. THREE YEARS LATER, AVANIR HAS A PRODUCT IN EACH PHASE OF CLINICAL DEVELOPMENT, ALONG WITH A PROMISING COMPOUND IN LATE-STAGE RESEARCH. THE CLINICAL DATA AVANIR HAS REPORTED FOR ITS LEAD PRODUCT, NEURODEX™, HAS PUT AVANIR IN A POSITION TO SUBMIT ITS NEXT NEW DRUG APPLICATION TO THE FDA IN 2004.



AVANIR'S FOCUS ON BUILDING A PORTFOLIO OF PRODUCTS AND ADVANCING THOSE PRODUCTS THROUGH CLINICAL DEVELOPMENT IS CLEARLY DELIVERING RESULTS. THE HARD WORK OF THE PAST THREE YEARS WILL CONTINUE THROUGH 2004, AS THE COMPANY PURSUES ADDITIONAL PARTNERING AGREEMENTS, MOVES COMPOUNDS THROUGH THE CLINICAL TRIAL PROCESS, AND SUBMITS AN NDA FOR NEURODEX™.

Letter to the SHAREHOLDERS

When I came to AVANIR, it was with a goal of creating a company with a portfolio of products. In the last five years, several different business paradigms have gone in and out of favor with Wall Street. But we stayed focused on our plan. By bucking the trend and staying true to our company's mission, we have created a rich and diverse product pipeline.

Our approach to research and drug discovery continues to produce high quality compounds for validated targets. We have a mix of internally developed and in-licensed compounds in the experienced hands of our research scientists. And as these compounds move through clinical trials, our development team makes sure a plan is in place and that these products progress according to plan down the path toward product approval.

FUELING THE DEVELOPMENT ENGINE

With a product in each phase of clinical development, fueling our research and development engine is a growing challenge. License fees, milestones and royalties from Abreva® sales have been an important source of cash for the company. As a result of our December 2002 agreement with Drug Royalty USA, we received $24.1 million in fiscal 2003 to fuel our existing research and clinical development programs. We anticipate securing partners in Europe in 2004 to expand our coverage in the European Union now that docosanol has received marketing approval from the Medical Products Agency (MPA) in Sweden. We are also focused on securing a partner to support the potential launch of Abreva® in the OTC market in Japan.

We are also in active partnership discussions for Neurodex™ and for our asthma/allergy, anti-inflammatory, and cholesterol compounds. We completed a $10 million private placement in July 2003, the net proceeds of which will support the clinical development of Neurodex™ in its first indication to treat pseudobulbar affect (PBA). Neurodex™ has the potential to be the first drug specifically developed to treat PBA, providing AVANIR access to an approximately $450 million market.

NEURODEX™ MOVES FORWARD

In November 2002, we reported strong clinical data from our first pivotal Phase III study of Neurodex™ in treating PBA in patients suffering from amyotrophic lateral sclerosis (ALS or Lou Gehrig's disease). Patients experienced a marked, statistically significant reduction in their symptoms upon receiving twice daily doses of Neurodex™. Some of these patients continued to receive Neurodex™ as part of an open-label study that was initiated in March 2003. We are

enrolling patients in our final Phase III study of Neurodex™ in treating PBA in patients suffering from multiple sclerosis (MS), and expect to submit a New Drug Application (NDA) in 2004.

To support the potential launch of this product, we have initiated physician and patient education programs to increase awareness of PBA, which can go untreated or be misdiagnosed as depression. These activities, including physician symposia and a new patient-oriented website (www.pseudobulbar.com), will continue as we progress toward potential FDA approval.

Neurodex™ may also prove beneficial for another group of patients, those suffering from diabetic neuropathic pain. In a Phase II open label, dose escalation study, Neurodex™ was well-tolerated and study participants reported pain relief and reduction in pain intensity. In fact, the degree of pain relief continued to increase with the duration of the study.

ALLERGY/ASTHMA RESEARCH OPENS NEW DOORS

We moved our second internally developed product from research into Phase I clinical testing this year. One of a series of compounds, AVP-13358 down regulates IgE, a key trigger in the onset of allergies and asthma. Interim results of a Phase I single dose escalation trial, reported in October 2003, demonstrated that the orally active drug was well-tolerated and even at low doses, attained biologically relevant plasma concentrations. We anticipate initiating a second safety trial in 2004 and have begun partnership discussions to co-develop this compound.

This family of compounds may act on additional diseases as well. Among other attributes, these compounds appear to possess anti-proliferative properties that may be useful in the treatment of cancer. This fact was confirmed when the National Cancer Institute (NCI) tested one of the compounds, AVP-893, and found that it was selectively potent against certain cancers. We therefore have a platform to partner, one that could be the foundation for compounds that could impact a variety of indications.

ANTI-INFLAMMATORY COMPOUNDS FURTHER ENHANCED

MIF stands for "macrophage migration inhibitory factor," a protein that when overproduced can trigger inflammatory diseases such as psoriasis, sepsis, inflammatory bowel disease (IBD), and rheumatoid arthritis. During the past year, we have made progress in discovering second- and third-generation MIF inhibitors. These small molecule, orally active drug candidates are more than 40 times more pharmacologically active than the structure we started with. Potential partners are intrigued by the preclinical data we have generated with these novel compounds.

CHOLESTEROL PROGRAM SHOWS PROMISE

AVANIR researchers have also uncovered a family of potent compounds that appear to behave much like HDL, the "good" cholesterol, in that they act to remove excess cholesterol from the body. By triggering cholesterol efflux, these orally active compounds could be powerful tools in treating high cholesterol.

XENEREX™ TECHNOLOGY ADVANCES

Funded by several government research grants, we've advanced our Xenerex™ technology to generate antibodies for the treatment of two life-threatening infectious diseases, anthrax, and

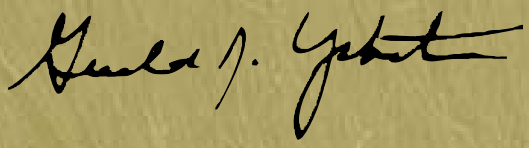
cytomegalovirus (CMV). Our anthrax research is being supported by grants from the U.S. Department of Defense and the National Institutes of Health and is focused on developing antibodies for use as prophylactic and therapeutic drugs to prevent and treat anthrax infections. Preclinical testing under these grants has shown that several antibodies generated using our Xenerex™ technology have demonstrated high potency against anthrax toxins *in vitro*. In addition, *in vivo* tests in mice showed that our lead antibody, AVP-21D9, conferred immediate immunity and appeared to assist in establishing long-lasting immunity. We are seeking additional federal grants to fund the remaining FDA-required testing of this biodefense product.

Our Xenerex™ technology has also shown promise in developing a treatment for CMV, a major cause of disease and death in immunocompromised patients and newborns. In May 2003, we received a $100,000 Phase I Small Business Innovation Research (SBIR) program grant to fund initial development of a panel of prospective monoclonal antibodies generated using our Xenerex™ technology. We are in the process of characterizing these antibodies for their neutralizing activity, specificity and affinity to CMV.

IT'S ALL ABOUT THE TEAM

We've worked hard to attract bright, enthusiastic people to AVANIR and to create an environment that fosters their creativity. I believe we have succeeded in building a spirit of teamwork and a unifying commitment to make this company successful. The same dedication and tenacity that have brought us to this point will guide us in meeting our goals in 2004. We look forward to keeping you informed of our progress and thank you for your continued support of AVANIR.

Sincerely,



GERALD J. YAKATAN

President and Chief Executive Officer
AVANIR PHARMACEUTICALS

AVANIR PHARMACEUTICALS

PORTFOLIO

NEURODEX™

AVP PLATFORM

MIF

CHOLESTEROL

XENEREX™ ANTIBODIES

ABREVA®


PBA
PBA
POLICE
POLICE

PBA & Pain

NEURODEX™

Neurodex™ is in two clinical trials at over 30 sites across the United States and in Israel. It is the very first drug candidate in clinical development to treat PBA, an emotionally crippling complication of certain neurodegenerative disorders and brain injuries. The condition, also known as "emotional lability," involves loss of emotional control, characterized by episodes of inappropriate laughing or crying and robs sufferers of meaningful interactions and relationships with family and friends. Approximately one million people throughout the world are afflicted with this condition.

We completed our first Phase III clinical trial of Neurodex™ in ALS patients last year and reported data that showed Neurodex™ significantly lowered the severity and frequency of patients' laughing/crying episodes almost two-fold. Not surprisingly, patients' overall quality of life and quality of relationship scores were greatly improved with two- to three-fold improvement shown for each measurement, respectively.

In 2004, we plan to complete a final Phase III clinical trial for treating PBA in MS patients. Data from both trials will be part of our planned NDA submission in the second half of 2004. While we conducted clinical trials of Neurodex™ in ALS and MS patients, the drug, if approved, will be helpful to other sufferers of PBA, including patients suffering from stroke, traumatic brain injury and Alzheimer's disease.

The second indication for Neurodex™ is in treating pain caused by diabetic neuropathy, a deterioration of peripheral nerves caused by diabetes. Neurodex™ could be one of the first drugs developed in the United States specifically to treat diabetic neuropathic pain. Such neuropathies can lead to pain, numbness, and weakness in the hands, arms, feet, and legs. The World Health Organization estimates that by 2005 there will be close to 300 million people worldwide with diabetes, of which more than 25% will develop diabetic neuropathy. IMS Health estimates that the market for neuropathic pain exceeds $1 billion.

Our Phase II clinical trial for Neurodex™ in treating diabetic neuropathic pain was completed in June 2003. Neurodex™ was not only well-tolerated, it significantly reduced patients' pain intensity. By Day 8 of the 29-day non-placebo controlled trial, 91% of patients reported significant pain relief and by Day 15, that number increased to 97%. These results clearly support moving forward and we are working with the FDA to develop the format for our Phase III clinical trials.

News from our Neurodex™ clinical trials has been very positive and has sparked interest from partners within and outside the United States. Our options include retaining the ability to market Neurodex™ for treating PBA in the United States and co-promotion or licensing to a partner that could also contribute to the development cost of our Neurodex™ program.

NEURODEX™

Planning AHEAD

INCIDENCE OF PBA

20% – 60%	*of ALS patients*
10% – 40%	*of MS patients*
15% – 30%	*of Alzheimer's patients*
16% – 40%	*of stroke patients*
5% – 15%	*of traumatic brain injury patients*

PBA = pseudobulbar affect
ALS = amyotrophic lateral sclerosis (Lou Gehrig's disease)
MS = multiple sclerosis

The PBA Market

For as long as people have suffered from neurodegenerative diseases, strokes, or traumatic brain injury, patients have experienced PBA. Globally, significant segments of each of these patient populations are afflicted with the condition.

But it is a condition that has often been misdiagnosed as depression or dismissed as an unavoidable complication of these disease states. Given the complexity of the condition and its causes, and the absence of an approved drug to treat it, physicians may not initiate therapy in their patients that have PBA.

The Education Component

Thanks to AVANIR, PBA is gaining more recognition as a disease condition that often walks hand in hand with certain neurodegenerative diseases and brain injuries. To help raise its profile, we've created a Scientific Advisory Board consisting of 15 leading physicians in neurology, psychiatry, pharmacology, and head injury. They'll be part of our core faculty for a series of accredited courses and symposia on the diagnosis and treatment of PBA. The first such course, presented by the University of Pennsylvania Medical School in October 2003, attracted 100 neurologists, psychiatrists and other specialists from the Philadelphia area. Other symposia will be held in Miami, Boston, Chicago, and Las Vegas in 2004.

To raise the profile of PBA with physicians on a more personal level, we intend to create regional advisory boards. In addition, we're creating an on-line medical education program for physicians and presenting at national physician conferences, including the National Stroke Association and the American Geriatric Society, to educate doctors about PBA. These efforts have been well received by organizations supporting stroke survivors and patients suffering from ALS, MS and Alzheimer's disease. They recognize all too well how devastating this condition can be when it goes untreated.

Our PBA education efforts aren't stopping with physicians. Patients and their families will benefit from a new website, www.pseudobulbar.com, which provides basic information about the condition. We're conducting patient outreach programs in major cities across the country. And we have committed funds for education grants for several patient advocacy groups to help enhance the awareness of PBA within their patient groups.

What It All Means

IMS Health has estimated PBA to be a $450 million market in the U.S. by 2005; Neurodex™ could be the first approved drug to treat this condition. And because PBA is intrinsically linked with neurodegenerative diseases, we'll see a corresponding increase in the incidence of PBA as the population ages.

By planning ahead and aligning our resources, we hope to establish awareness of PBA among potential prescribers of Neurodex™ well before the potential launch of the drug. We hope that by increasing awareness among physicians, we will increase the number of diagnosed cases, and thus improve the chances that patients and their families will finally receive relief from this devastating condition.


EISENHOWER · USA
8c
REMARKABLE FLOWERS

AVP PLATFORM *expands POTENTIAL*

ALLERGY ASTHMA CANCER

AVP-13358 was the subject of a Phase I single rising dose clinical trial in 2003. It is one of a series of compounds developed by our researchers. This orally active compound is designed to act early in the body's response to allergens by preempting the production or release of IgE and other mediators involved in triggering the onset of asthma and allergic rhinitis.

Asthma and allergy are very large markets. Each year more than 50 million Americans suffer from allergic diseases and their prevalence continues to grow, reflecting both increased exposure and enhanced responses to allergens. Allergic diseases are the sixth leading cause of chronic disease in the United States, costing the healthcare system over $18 billion annually.

An estimated 15 million Americans suffer from asthma, with 200 million people affected worldwide. Annual costs for asthma in the United States are estimated to be $14.5 billion. The current cost of prescription medication for asthma is more than $2.5 billion in the United States and exceeds $10 billion worldwide.

In preclinical studies, AVP-13358 selectively inhibits the production or release of the ultimate mediator (IgE antibodies) and a critical group of Th2 cytokines thought to regulate the process that ultimately manifests as asthma or allergies. Existing drugs such as antihistamines act to suppress the symptoms of allergy but have little effect on the development or progression of the condition.

Why are we so excited about this product? No orally active allergy drugs are currently marketed for the treatment of excess IgE or Th2 cytokines. A compound that acts on these critical mediators could prove to be a very useful new tool in the treatment of asthma and allergic rhinitis.

We hope to follow the single rising dose safety trial we conducted in 2003 with a multiple dose safety trial in 2004.

A New Platform

In looking at the mechanism of action for this series of compounds, we discovered that this family of compounds appears to have unique properties. Among other things, it appears to possess anti-proliferative abilities, i.e., some of these compounds could prove effective in fighting cancer.

To test its anti-proliferative nature, we asked the National Cancer Institute (NCI) to analyze one member of this compound family, AVP-893. NCI scientists put this compound through a variety of tests, analyzing its core structure compared to NCI's extensive cancer compound library, and testing it against a 60-cell cancer cell line assay. Not only did they confirm that this compound was selectively potent against certain types of cancers, but they also found that its core structure was unique. To test it further, NCI is conducting *in vivo* studies. If this compound shows *in vivo* cancer-fighting activity, NCI may recommend it for further testing.

What does this mean for Avanir? It means we have more than just a series of compounds; we have a platform that may be partnered for more than one indication, increasing the potential revenue that we could derive from one or more licensing partners.

RESEARCH

Novel COMPOUNDS *to take into* DEVELOPMENT

We are very encouraged by the strong data we've obtained for the four compounds we have in preclinical research. One is the optimized version of an acquired compound, two were generated with our patented Xenerex™ technology, and another is an internally developed compound.

Anti-inflammatory

The overproduction of macrophage migration inhibitory factor (MIF), is the target of our most advanced preclinical research program. There's been a renewal of interest in this target, which while well understood, has been difficult to tackle.

MIF is believed to play an important role in many inflammatory diseases, including rheumatoid arthritis, Crohn's disease, inflammatory bowel disease (IBD), and sepsis. It was initially thought to regulate one of the early steps in the inflammation process, called macrophage migration. However, the current belief is that the mechanism of MIF action is based on its ability to suppress the anti-inflammatory steroid response. There are no known, commercially available compounds that are designed to inhibit the activity of MIF. Our scientists have succeeded in significantly enhancing the potency of our original in-licensed MIF compound and have developed a series of potent, small molecule compounds that have been shown to inhibit MIF *in vivo*. We now have second- and third-generation compounds that show promise. In *in vitro* preclinical experiments, these compounds have significantly lowered MIF and TNFa serum levels and have exhibited high potency. In fact a candidate we've identified is over 40 to 50 times more potent than its predecessor.

Cholesterol

Atherosclerosis and hypercholesteremia are the leading causes of cardiovascular disease. There are drugs on the market that lower LDL, the "bad" cholesterol contributing to blood vessel and artery plaques that can lead to heart attacks. Called "statins," these drugs accounted for over $15 billion in sales in 2002.

However, they do have their limitations, including liver toxicity and drug interactions. They also lack efficacy in certain patient populations.

There are currently no drugs on the market that mimic the beneficial affects of HDL, the "good" cholesterol that helps to transport cholesterol out of our bodies. However, AVANIR scientists believe they have identified a family of compounds that appear to do just that. Starting with a large molecule peptide, they've succeeded in developing a series of water soluble, small molecules that promote cholesterol efflux, i.e., they mimic HDL by removing excess cholesterol from the body by facilitating direct and indirect reverse cholesterol transport.

We're focused on further enhancing the characteristics of this chemical family and identifying a lead compound to take into clinical trials.

Infectious Disease Antibody Research

Our Xenerex™ technology efforts are now focused on producing antibodies that we can develop ourselves (or with partners) to treat important infectious diseases, rather than on performing contract research for other companies. This patented technology involves engrafting human immune cells into mice that lack a functional immune system. Immunizing the mice with disease agents results in the production of human antibodies against the disease targets. We worked hard this year to capture the power of this technology and put it to work in developing treatments for two important infectious diseases, anthrax and cytomegalovirus.

Anthrax Antibody

Under grants from the U.S. Department of Defense administered through the Center for Commercialization of Advanced Technology (CCAT) and the National Institute of Allergy and Infectious Diseases (NIAID), we are developing anthrax antibodies for use as a prophylactic and therapeutic drug to prevent and treat anthrax infections. These antibodies are designed to bind to and neutralize the anthrax protective antigen (PA). PA is a component of the anthrax toxins that enables anthrax's lethal factor (LF) and edema factor (EF) to enter cells and deliver their deadly effect.

Our efforts to date in developing anthrax antibodies have been stellar. Based on published research, our Xenerex™-generated AVP-21D9 anthrax antibody is 33-fold more potent in the rat model than other antibodies in development. One dose appears to protect animals completely, even to subsequent anthrax challenge weeks later. One molecule of the antibody AVP-21D9 is capable of neutralizing two anthrax toxin molecules in rat models, a ratio that shows exceptional potency.

AVP-21D9, or one of our other anthrax antibodies, could be used in a variety of ways, as an augmenting vaccination, as a stand-alone prophylactic drug, or in combination with antibiotics. To progress this work further, we're seeking additional federal grants that will support more *in vivo* animal studies as well as non-human efficacy studies, toxicology testing, and cGMP manufacture of clinical supplies. According to the guidelines of the Bioterrorism Act of 2002, the FDA may consider successful studies in relevant animal models sufficient to establish efficacy for licensure and marketing approval.

The potency of AVP-21D9 could provide the government with a cost-effective anthrax therapeutic (although we hope we are creating a therapeutic that will never have to be used).

CMV Antibody

We are also working to develop antibodies to treat cytomegalovirus (CMV). Infection with CMV is a major cause of disease and death in immunocompromised patients and newborns. In particular, maternal-fetal transfer of CMV infection results in a fetal death rate of 12%. Those babies who survive have permanent debilitating disorders, including mental retardation, vision loss and deafness.

In May 2003, we received a Phase I Small Business Innovation Research (SBIR) grant from the NIH to fund initial development of Xenerex™ technology-based human monoclonal antibodies for CMV. We have generated a panel of prospective monoclonal antibodies and are in the process of characterizing them as to neutralizing activity, specificity and affinity to CMV. We hope to obtain a larger Phase II SBIR grant that we'll be able to use to advance one or more of our CMV antibody candidates to the clinical testing phase.

In addition to these two indications, we'll continue to investigate use of our Xenerex™ technology to develop antibodies for other infectious diseases.


abreva







FDA-APPROVED for cold sores

ABREVA®

Abreva® was our first FDA-approved product and has generated revenues from milestones, fees and royalties that have helped to fuel our other development programs. To date, it has delivered $55 million in cash to AVANIR.

GlaxoSmithKline is AVANIR's marketing partner for Abreva® in North America. Strong sales in the U.S. have helped Abreva® become one of GSK's top twelve consumer products. The double-digit growth rates for Abreva® are a clear measure of its success as the only FDA-approved cold sore treatment for sale in the over-the-counter market. In fact, it's the largest selling consumer healthcare product in the United States for the treatment of cold sores.

In December 2002, we sold a portion of the future royalty stream from North American sales of Abreva® to Drug Royalty USA for an initial payment of $20.5 million. Under the terms of that agreement, we retain rights to 50% of royalties earned on contract sales of Abreva® in excess of $62 million a year in North America. In 2002, GSK's retail sales of Abreva® were approximately $50 million.

In May 2003, we received word from the U.S. Patent and Trademark Office that it was extending the term of AVANIR's key Abreva® patent by five years, increasing the life of the patent to 2014. This news also triggered an additional $3.6 million payment from Drug Royalty USA.

AVANIR also retained the rights to all current and future royalties from product sales of docosanol in the rest of the world. To date, AVANIR has extended its docosanol franchise by licensing docosanol to companies intending to market the product in certain countries in Europe, Asia and the Middle-East. In addition to the U.S., docosanol is now being marketed in Israel under the name Abrax™ and in South Korea, under the name Herepair™ by our partner companies in those countries. In Japan, we are in the process of securing a marketing partner with expertise in the Japanese over-the-counter (OTC) marketplace.

In November 2003, we received marketing approval for docosanol from the Medical Products Agency (MPA) in Sweden. This is the first step in the mutual recognition process to obtain regulatory approval in the European Union. We anticipate approvals from several other countries in the EU to be secured in 2004.

Letter from the CHIEF FINANCIAL OFFICER

We continue to strive to report the financial standing of our company in a clear, concise and transparent fashion. As you will see in this annual report on Form 10-K and in our quarterly reports throughout the year, we endeavor to clearly describe our strategies and progress as we move products through research and clinical trials.

As we develop and commercialize our portfolio of products, we'll continue to make our financial reporting and balance sheet tabulations as clear and transparent as possible. We thank you for your support of Avanir and look forward to communicating with you throughout the next fiscal year.

Sincerely,

Gregory P. Hanson

Vice President, Finance and CFO
Avanir Pharmaceuticals

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Telephone: 718-921-8200

ANNUAL MEETING

The Annual Meeting of Shareholders will be held on March 18, 2004 at 10:00 a.m. at the Company's Conference Center at 11404 Sorrento Valley Road. All shareholders are cordially invited to attend.

SHAREHOLDER INFORMATION

Shareholders of record needing to change their name or address, or to replace lost stock certificates, please write or call our transfer agent. Shareholders wishing to be added to the Company's e-mail list should sign up at www.avanir.com or contact Investor Relations (858-622-5202).

AVANIR COMMON STOCK

The Company's shares of Class A Common Stock trade on the American Stock Exchange under the symbol AVN.

CORPORATE OFFICES

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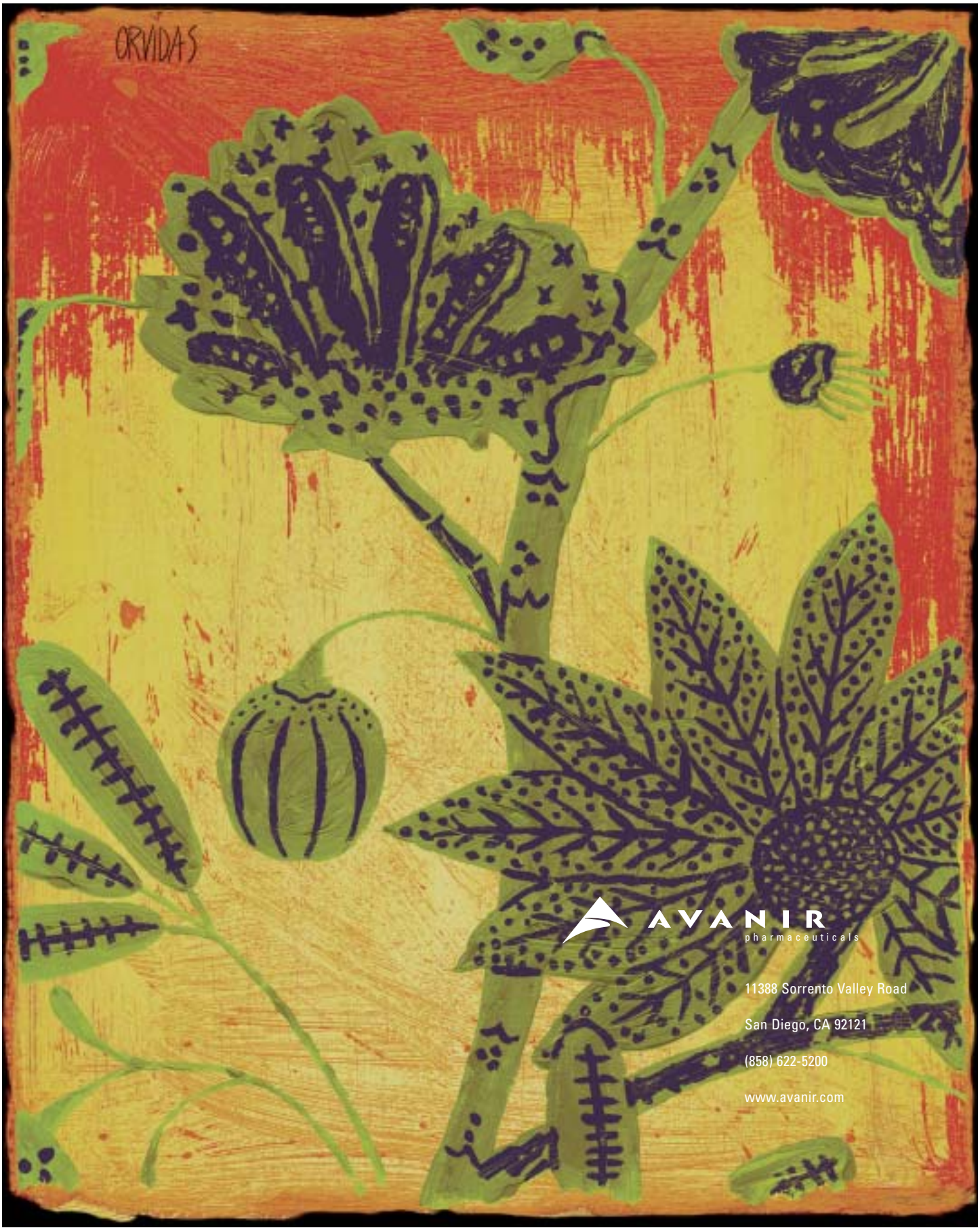

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