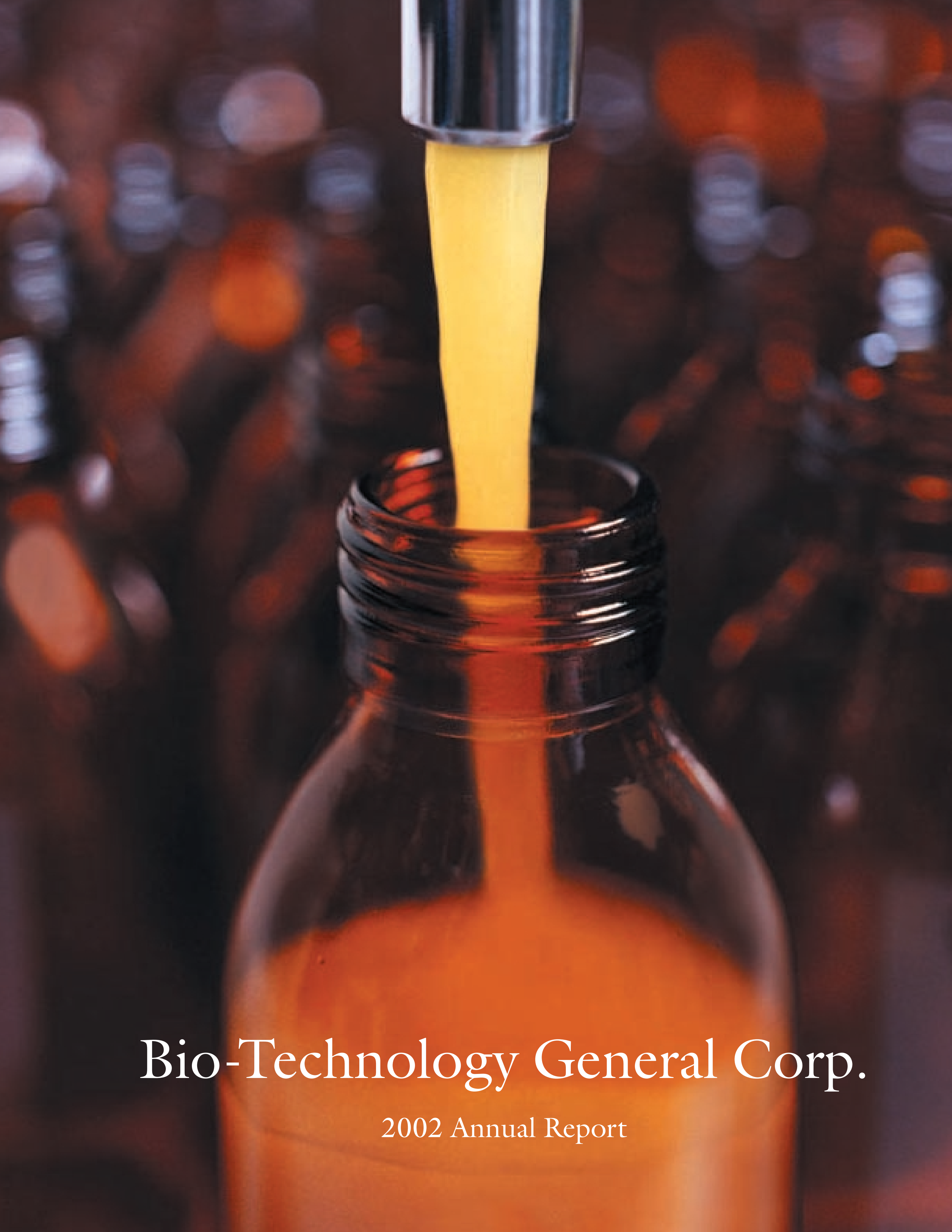

Bio-Technology General Corp.

2002 Annual Report

Prescriptions for Health and Commercial Success

In 2002, a growing number of our products lined pharmacy shelves and improved the well-being of people worldwide. These achievements were made possible by our market-driven corporate culture and our commitment to creating profit while making the world a healthier place.

U.S. Sales: Products marketed by our domestic sales force include Oxandrin for the treatment of involuntary weight loss and Delatestryl for hypogonadism in men.

U.K. Sales: Rosemont Pharmaceuticals Limited, our U.K. subsidiary, develops, manufactures, and markets a wide range of oral liquid formulations of therapeutic products primarily for the U.K. pharmaceutical market.

Other Sales: Our subsidiary Bio-Technology General (Israel) Ltd. manufactures Bio-Tropin for growth hormone deficiency in children; BioLon for ophthalmic surgical procedures; Bio-Hep-B, a recombinant hepatitis B vaccine; and Arthrease for osteoarthritis. Products marketed by our licensees in the United States are Mircette, an oral contraceptive, and BioLon; and in international markets, Bio-Tropin, BioLon, Bio-Hep-B, Silkis for psoriasis, Arthrease, and recombinant human insulin.

Financial Highlights

in thousands, except per share data

Years ended December 31	2001	**2002**[1]
Revenues	$ 94,774	**$102,966**
Expenses	69,438	**89,828**
Write-off of acquired R&D	45,600	**—**
Other income (expense), net	(4,929)	**1,642**
Net income (loss)	(29,926)	**9,717**
Diluted earnings (loss) per share	(0.52)	**0.17**

1. Includes Rosemont's operations from September 30, 2002.

Who We Are

A competitor in the biopharmaceutical industry since 1980, Bio-Technology General Corp. (BTG) develops, manufactures, and markets diverse human health-care products. Focusing on products that positively affect both the course of disease and the quality of life, we strive to fill unmet medical needs worldwide.

By balancing scientific expertise with a market-driven business strategy — manifested through selective acquisitions, collaborative relationships, and productive licensing arrangements — BTG has matured into an integrated specialty pharmaceutical company.

Today we are a force in the marketplace, with commercial products marketed by us domestically and in the United Kingdom, and by licensees around the globe. We will continue to build on this solid foundation — and fulfill our commitment to introduce additional therapeutic products, provide unique treatment options, and improve health and quality of life.

Dear Fellow Stockholder:

Since achieving profitability in 1995, we at BTG have faced the challenge of continuing to grow our business while responding to inevitable changes in the pharmaceutical marketplace. In striving to meet this challenge, we have adopted a three-part strategy of growth through investment. Forward-looking, bold, and confident, it is an approach designed to maintain a competitive edge while delivering sustainable profit.

Growth through Driving Market Share Our business achievements in 2002 reflect our commitment to this strategy. One key initiative was increasing the size of our U.S. sales force by 20%, enabling us to expand marketing and sales activities for our top-selling drug, Oxandrin, an oral anabolic agent for the treatment of involuntary weight loss. Through this effort, we succeeded in covering new market segments and driving strong growth in both prescriptions and sales from wholesalers to end users which, by the end of 2002, reached a new high of approximately $70 million.

Sim Fass, Chairman & CEO (standing)
Christopher Clement, President & COO (seated)

Over the year leading up to this, Oxandrin prescriptions grew 22%, paralleling end-user sales growth of 21%. Retail prescriptions, representing approximately 64% of the total, grew 28% in 2002, whereas prescriptions in the long-term-care sector grew 19%. Adding to the growth momentum of this product was the introduction of our new 10-mg Oxandrin tablet, launched in late 2002.

Further supporting our Oxandrin initiatives, we renegotiated our agreement with Accredo, which had been our exclusive U.S. distributor for Oxandrin. Under the revised arrangement, we now sell both Oxandrin and Delatestryl directly to wholesalers, while Accredo provides us with certain fee-based services. This creates greater efficiencies and enhanced control over inventories and product supply. We anticipate additional benefits, such as closer correlation between our Oxandrin net sales and end-user sales, as well as a broader accounts receivable base.

Growth through Selective Acquisitions The highlight of 2002 was our acquisition, on September 30, of Rosemont Pharmaceuticals Limited, a U.K. company specializing in oral liquid formulations of pharmaceutical products. This acquisition transformed our Company immediately, adding a broad portfolio of highly successful pharmaceutical products that hold a leading position in a niche U.K. market sector. As a result, BTG has become an international specialty pharmaceutical company, with operations in the United States, the United Kingdom, and Israel, and sales worldwide.

An important benefit of the acquisition is greater diversification of our sales, decreasing our dependence on specific products or markets, and resulting in 54% of sales in the United States, 21% in the United Kingdom, and 25% in the rest of the world. The acquisition provides a European base of operations and a dedicated sales force in the United Kingdom. We intend to tap into this potential, with an eye toward introducing into the European market various proprietary products currently under development.

Our sales forces in the United States and the United Kingdom now generate approximately 75% of revenues, effectively reducing our reliance on third parties and providing greater revenue stream control.

Growth through Developing Proprietary Products Early in 2002, we announced our intention to invest more heavily in research and development to advance our three pipeline drug candidates and to pursue, in collaboration with Teva, our biogenerics program.

Puricase, our drug candidate for the treatment of intractable gout, was brought into the clinic with an initial Phase I safety study; we added a second Phase I study to refine its mode of delivery and assess outcomes based on this change.

For Prosaptide, a novel nerve growth factor peptide that may have utility in the treatment of neuropathic pain, we designed the protocol for a Phase II(b) clinical safety and dose-ranging study. Planned in collaboration with the Neurologic AIDS Research Consortium, this study will be conducted at multiple sites around the United States during 2003 and 2004.

In 2002, we also advanced our scientific understanding of BTG-271, a human monoclonal antibody. Now in development for the treatment of acute myeloid leukemia, we established its affinity and specificity to a range of leukemic cell types at various stages of differentiation. Further pre-clinical studies will allow us to determine this product's future clinical direction, and we are hoping for an IND filing for BTG-271 by 2004.

Bringing these products from the clinic to market is imperative to our growth. It will protect us against the eventuality of maturing product sales, changes in product demand, or the possibility of generic encroachment. Therefore, as in 2002, we are increasing our commitment to research and development expenditure in 2003 in absolute dollar terms, but we expect it to remain relatively constant (at approximately 30%) in terms of percentage of sales.

Financial Achievements and Aspirations Notwithstanding our stepped-up investment in research and development and marketing and sales, we delivered earnings in 2002 of $0.17 per share. Total revenues of $103 million increased 9%, reaching a new high; product sales reached a level of $96 million, an increase of 10%; and net income was $9.7 million.

In sum, the value of the Rosemont business, our enlarged U.S. sales force, our Oxandrin marketing and sales initiatives, the upward trend in prescriptions, and the transition to a direct-to-wholesaler business model for Oxandrin and Delatestryl add up to continued success. We expect 2003 revenues and earnings per share to be spurred on by these activities and achievements.

In terms of expenses, we expect increases due to our strong commitment to our pipeline products and their associated R&D costs. We also anticipate incremental investment in marketing and sales to maximize the commercial potential of our products in the United States and the United Kingdom.

Looking Ahead…and Looking Beyond Two esteemed colleagues, both members of our board of directors, have chosen to step down in 2003. Allan Rosenfield, M.D., a board member since 1997, will be devoting more time to his academic activities and commitments, and we thank him for his contributions over the years. Dan Tolkowsky, a founding board member, is retiring after more than twenty years of providing BTG with his business acumen, invaluable guidance, and counsel. We are deeply indebted to him for his direction and support over the course of his long and distinguished service.

Our strategy to further our business interests has already taken us far and is advancing our business steadily. In a world of economic and political challenges, our ability to meet those presented to BTG in 2002 is a tribute to the leadership of our senior management and the dedication of our staff worldwide. We wish to acknowledge their commitment, resolve, and team spirit. We have every confidence that their contributions will continue to yield success in the future.

Sincerely,

Christopher Clement
President and Chief Operating Officer

Sim Fass
Chairman and Chief Executive Officer

A Solid Foundation

Three key building blocks form the foundation of our business strategy. By remaining focused on a consistent mission, clear marketing message, and strategically leveraged business relationships, we ensure value for consumer and shareholder alike.

At BTG, we are committed to:

- Driving market share growth to maximize the potential of our commercialized products worldwide. We believe they will continue to generate significant ongoing growth, and make important contributions to revenues and earnings.
- Executing selective accretive acquisitions whenever possible. In addition to further enhancing the growth of our base specialty pharmaceutical business, acquisitions will support the development of our proprietary pipeline products.
- Developing and commercializing our proprietary pipeline products. Our goal is to introduce new treatment options, and create solutions to unmet medical needs in both niche and general markets.

Driving Market Share

While each of our approved products contributes to our sales and revenue stream, we believe each has additional growth potential that we hope to realize in the near future. Using a variety of tools — from domestic sales initiatives to creative associations with strategically positioned marketing partners and licensees — we seek to maximize opportunities for all our products.

Our enlarged U.S. sales force, selling to an expanded physician universe of key prescribers, is hard at work promoting Oxandrin for the treatment of involuntary weight loss. This sales team is also central to our mission of driving Oxandrin sales growth through the introduction of our 10-mg tablet.

In addition, we foresee revenue growth from several other products. Arthrease, which is pending FDA approval, will be marketed in the United States by DePuy. Human growth hormone, when introduced domestically, will be marketed by Teva. As Bio-Hep-B gains additional approvals, it is slated to be launched in Europe and the Far East. We anticipate the introduction by Akzo Nobel, in 2004, of our recombinant human insulin in some major markets. Finally, we are confident that Rosemont's oral liquid products business will prove to be a driver of sales in both the near future and over the long term.

Accelerating Growth

In 1993, when BTG acquired Gynex and with it Oxandrin and Delatestryl, we embarked on a dynamic strategy: creating growth through acquisitions. With financial success as our benchmark, the past decade proves that such an approach works.

In 2001, we acquired Myelos, bringing with it rights to Prosaptide, an exciting nerve growth factor peptide. Recognizing the time and cost factors involved in bringing it and other pipeline products to market, and acutely aware of the finite growth potential of all commercial products, we began searching for the next acquisition. This one would need to be accretive and have synergies that could enhance our future value.

Purchased in 2002, with cash generated from internal operations, Rosemont secures a significant revenue stream to help support the development of our proprietary pipeline products and overall growth.

Today, our acquisitions track record speaks for itself: Oxandrin is our leading product, Rosemont is a robust business, and Prosaptide has the potential to increase BTG's commercial value. Making acquisitions that make sense has propelled us to profitability, supported our in-house product development, and positioned us well to attain even greater growth and increased shareholder value.

From Pipeline to Patient

Research and development has been a defining BTG characteristic since our inception. It has allowed us to bring to market a diverse portfolio of profitable products. And it is the bedrock on which we created resources to grow our business, support acquisitions, and invest in proprietary drug candidates.

Our earliest R&D efforts were in the area of recombinant proteins such as human growth hormone, hepatitis B vaccine, and human insulin. Further applying this technological expertise and fermentation know-how, we developed BioLon and Arthrease. Our focus now is on bringing several new ideas from clinical development to pharmacy shelf, including Prosaptide for neuropathic pain, Puricase for intractable gout, and BTG-271 for acute myeloid leukemia.

We know that through research and development we can, and do, make a difference in the lives of countless patients and their families. As new technologies become available… as the scientific and medical communities continue to make advances… and as our business continues to grow, we reaffirm our commitment to exploring bold new ideas and making a meaningful contribution to health care.

Driving Market Share

With commercial products ranging from Oxandrin, Delatestryl, human growth hormone (hGH), and BioLon — to the more recently introduced and marketed — Arthrease, Bio-Hep-B, and human insulin — we are well on the way to creating a diversified and well-balanced portfolio.

However, our products have yet to reach their peak sales potential. So our focus today is to continue to drive and grow market share through further penetration of existing markets, product introductions in new territories, and line extension opportunities. Marketing efforts undertaken in 2002 included increasing our U.S. sales force and launching the 10-mg Oxandrin tablet.

We expect our total product sales to grow in 2003 — this despite the competitive pharmaceutical environment, possible supply constraints for Delatestryl, and ongoing pricing pressures in the Japanese pharmaceutical marketplace for hGH.

Oxandrin The primary driver of our sales is Oxandrin. The importance of the new 10-mg dosage is that it positively impacts the more than 40% of patients taking the maximum approved dose of 20 milligrams a day. The more convenient formulation allows these patients to switch from eight tablets daily to two (taken in divided doses), and is expected to result in improved adherence to therapy, better treatment outcomes, and continued prescription and sales growth.

Human Growth Hormone Marketed around the world, our hGH is increasing its presence in Japan through our relationship with JCR (and, indirectly, through Sumitomo), and in Europe through our collaboration with Ferring. We are hoping for sales growth from this product once Teva, our U.S. marketing partner, launches hGH domestically.

Newer Products As our recently introduced products gain further approvals and are launched in additional territories, they will become more significant contributors to our sales and earnings. Drivers of new product sales are likely to be: the approval and introduction of Arthrease in the United States, to be launched by DePuy; sales initiation in 2004 of our human insulin by Akzo Nobel’s Diosynth division; and approval of Bio-Hep-B in Europe, anticipated in 2005, and its subsequent launch.

In addition, royalties continue to be generated by Mircette, an oral contraceptive product licensed to Organon and sold in the United States, and Silkis, a vitamin D anti-psoriasis product licensed globally to Galderma and sold in Europe and South America.

OXANDRIN®
10 mg
OXANDRIN®
(oxandrolone tablets, USP)
10 mg
60 tablets
℞ only

Accelerating Growth

While acquisitions are a central element of our Company's long-term growth strategy, our fundamental concern is to make acquisitions that make sense. They must enhance our current product offerings and dovetail into our existing culture.

Strategic Acquisition In September 2002, we succeeded in making such a match by acquiring Rosemont Pharmaceuticals Limited. A unique company with a leading position in the rapidly growing U.K. market for oral liquid pharmaceutical products, Rosemont develops, manufactures, and markets drugs for patients who — because of age, medical conditions, or personal preference — take medication in oral liquid form.

In filling this market niche, Rosemont products command premium pricing in comparison to competing tablet formulations, generating attractive gross margins that approximate those of patent-protected products. Operating in a fast-growing market sector — approximately 15% per annum, or twice the growth rate of the overall U.K. pharmaceutical market — Rosemont seeks to introduce four to six new prescription products in oral liquid form every year.

Creative Expansion Rosemont strengthens our specialty pharmaceutical portfolio, provides healthy diversification of our revenue stream and earnings base, is expected to be a key driver of sales growth, and is significantly accretive to earnings in 2003. But Rosemont brings more to BTG than a superior track record. This acquisition also offers a creative way to expand markets, build business relationships in the United Kingdom, and sustain growth.

For example, currently about 95% of Rosemont's business is generated exclusively within the United Kingdom; for us it represents both a valuable local presence and a springboard for future expansion throughout Europe. And while Rosemont primarily serves the geriatric population, its products could be applied to the pediatric market, where oral liquids would be of obvious advantage.

A Long-Term Approach Finally, by applying Rosemont's technology to BTG's existing products, we have the potential to realize scientific and medical synergies, demonstrating that the best acquisition is one that sparks creative collaborations, expands possibilities, and opens the door to profitable opportunities.

From Pipeline to Patient

Moving products from pipeline to patient is a slow, painstaking, and uncertain process. The good news is that we believe we are on the way to developing several promising pharmaceutical products.

Prosaptide Most drugs prescribed for the relief of peripheral neuropathic pain produce dose-limiting side effects. In contrast, early clinical data on Prosaptide, a nerve growth factor peptide derived from the human protein prosaposin, suggest it may prove to be unique in relieving neuropathic pain without the usual side effects. Our Phase II(b) clinical safety and dose-ranging study will last into 2004. Assuming our successful establishment thereafter of safety and efficacy in Phase III studies, Prosaptide could become a prime treatment for a target population that exceeds 300,000 individuals in the United States alone.

Puricase Severe, untreatable gout — characterized by abnormally high uric acid levels in the blood — affects approximately 32,000 individuals in this country. Puricase, a genetically engineered uricase enzyme, converts uric acid into a highly soluble, more easily eliminated substance. Our initial Phase I safety study evaluated the effects of a single escalating dose of Puricase, administered by subcutaneous injection. While a definite reduction in serum uric acid levels was observed, some patients manifested skin hypersensitivity. However, because this reaction may be avoided by administering the drug intravenously, we have undertaken a second study, a Phase I single intravenous dose study. If successful, we anticipate that a Phase II clinical safety and efficacy trial will be initiated during 2003.

BTG-271 Despite major recent advances in treating hematological cancers, acute myeloid leukemia (AML) remains a devastating, life-threatening disease, annually affecting approximately 11,000 newly diagnosed individuals in the United States. Our pre-clinical work with BTG-271, a human monoclonal antibody, suggests it binds to a variety of leukemic cell types and stem cells. By not binding to normal stem cells, it potentially reduces the likelihood of serious side effects. If pre-clinical study data support our hypothesis, the full antibody will be linked to a chemotherapeutic drug — joining together to destroy AML cells and extend duration of remission — and we would expect to file an IND by 2004.

Bio-Generic Products Our pipeline arsenal of drug candidates includes two generic versions of recombinant drugs with expiring patents. We are currently developing and will produce these drugs for Teva, which will commercialize them. Creative partnerships such as this underscore our commitment to getting BTG products to market swiftly and safely.


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Financial Profile

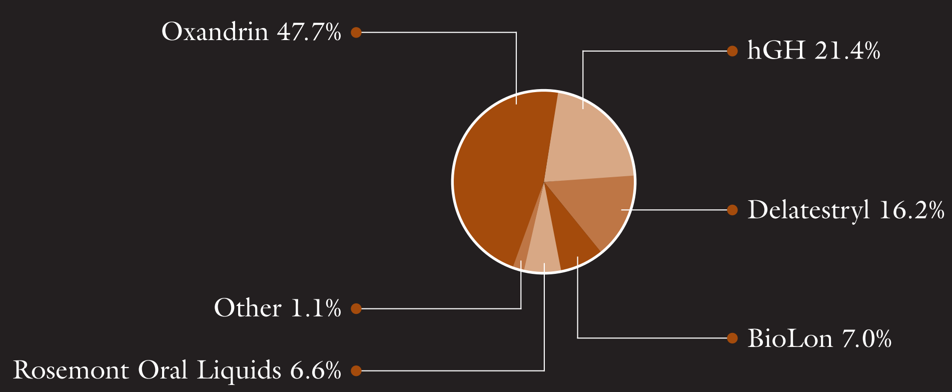
Product Sales as a Percentage of Total Revenues

dollars in thousands

2002 Sales by Product

dollars in thousands

Total Sales $96,107

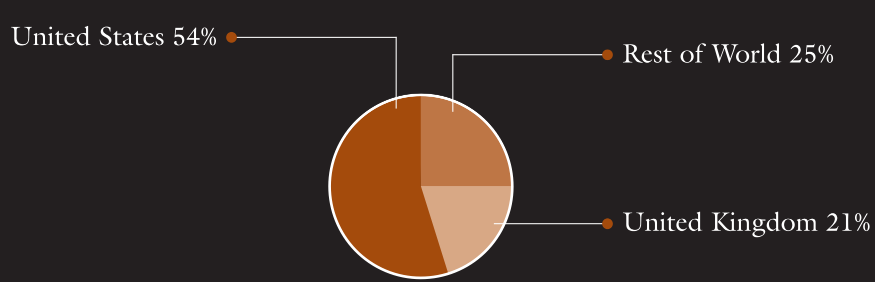


2002 Product Sales by Territory

including Rosemont as of January 1, 2002

pro forma, dollars in thousands

Total Sales $112,235



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Statements in this Annual Report concerning BTG's business outlook or future economic performance; anticipated profitability, revenues, expenses, or other financial items; introductions and advancements in development of products, and plans and objectives related thereto; and statements concerning assumptions made or expectations as to any future events, conditions, performance, or other matters are "forward-looking statements" as that term is defined under the Federal Securities Laws. Forward-looking statements are subject to risks, uncertainties, and other factors that could cause actual results to differ materially from those stated in such statements. Such risks, uncertainties, and factors include, but are not limited to, changes and delays in product development plans and schedules, changes and delays in product approval and introduction, customer acceptance of new products, development, introduction, or consumer acceptance of competing products, changes in pricing or other actions by competitors, patents owned by BTG and its competitors, changes in health-care reimbursement, risk of operations in Israel, risk of product liability, governmental regulation, dependence on third parties to manufacture products and commercialize products, and general economic conditions, as well as other risks detailed in our filings with the Securities and Exchange Commission, including the Company's Annual Report on Form 10-K.

Selected Consolidated Financial Data

in thousands, except per share data

Years ended December 31	1998[1]	1999[1]	2000[1,2]	2001[1,3]	2002
Statement of Operations Data:					
Product sales, net	$ 68,246	$ 60,332	$ 62,149	$ 87,106	**$ 96,107**
Total revenues	73,890	78,687	72,761	94,774	**102,966**
Write-off of in-process research and development acquired	—	—	—	45,600	**—**
Total expenses	51,623	64,903	67,396	115,038	**89,828**
Operating income (loss)	22,267	13,784	5,365	(20,264)	**13,138**
Other income (expense), net	2,798	4,445	7,376	(4,929)	**1,642**
Income tax expense	7,124	4,821	3,798	4,733	**5,063**
Income (loss) before cumulative effect of change in accounting principle	17,941	13,408	8,943	(29,926)	**9,717**
Cumulative effect of change in accounting principle	—	—	(8,178)	—	**—**
Net income (loss)	$ 17,941	$ 13,408	$ 765	$ (29,926)	**$ 9,717**
Earnings (loss) per common share:					
Basic:					
Income (loss) before cumulative effect of change in accounting principle	$ 0.37	$ 0.26	$ 0.16	$ (0.52)	**$ 0.17**
Cumulative effect of change in accounting principle	—	—	(0.15)	—	**—**
Net income (loss)	$ 0.37	$ 0.26	$ 0.01	$ (0.52)	**$ 0.17**
Diluted:					
Income (loss) before cumulative effect of change in accounting principle	$ 0.36	$ 0.25	$ 0.15	$ (0.52)	**$ 0.17**
Cumulative effect of change in accounting principle	—	—	(0.14)	—	**—**
Net income (loss)	$ 0.36	$ 0.25	$ 0.01	$ (0.52)	**$ 0.17**
Weighted average shares outstanding:					
Basic	48,184	52,348	54,320	57,230	**58,480**
Diluted	49,848	54,191	56,885	57,230	**58,659**

As of December 31	1998	1999	2000[2]	2001[3]	2002
Balance Sheet Data:					
Working capital	$110,359	$120,587	$154,089	$139,472	**$ 29,059**
Total assets	142,797	162,538	209,960	235,086	**285,431**
Long-term liabilities	3,818	4,333	24,593	24,125	**17,895**
Stockholders' equity	123,179	140,534	152,645	157,540	**169,075**

continued on page 15

Selected Consolidated Financial Data *continued*

1. Certain revenue and expense items have been reclassified to conform to current-year presentation.
2. Effective January 1, 2000, Bio-Technology General Corp. ("BTG") adopted Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," issued by the Securities and Exchange Commission in December 1999. As a result of adopting SAB No. 101, BTG changed the way it recognizes revenue from contract fees for the license of marketing and distribution rights where the consideration is a one-time non-refundable payment. Prior to the issuance of SAB No. 101, BTG recorded revenue from the license of marketing and distribution rights when the rights were licensed and/or when these payments were received. Effective January 1, 2000, BTG recorded a cumulative effect of a change in the accounting principle related to contract revenues recognized in prior years in the amount of $12,558,000, net of income taxes of $4,380,000, of which $853,000, $1,156,000, and $1,146,000 were recognized as contract fee revenues in 2000, 2001, and 2002, respectively. Contract revenues are now being recognized over the term of the related agreements.
3. In connection with our acquisition of Myelos Corporation ("Myelos") and based on an independent valuation, BTG allocated $45,600,000 to in-process research and development projects of Myelos, representing the estimated fair value based on risk-adjusted cash flows of the acquired technology. At the date of the acquisition, the technology acquired in the acquisition was not fully commercially developed and had no alternative future uses. Accordingly, the value was expensed as of the acquisition date. BTG recorded negative goodwill of $18,914,000 on its balance sheet, primarily because the amount written off as in-process research and development acquired exceeded the purchase price for accounting purposes. This negative goodwill was being amortized over its expected useful life of five years and had the effect of reducing reported expenses by $2,961,000 during 2001. In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," amortization of the negative goodwill ceased beginning January 1, 2002, and the balance remaining will be maintained as a deferred credit until it is either netted against the contingent payments or reflected in net income as an extraordinary item, should the contingent payments not become due because the technology did not meet the milestones that trigger payment.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are engaged in the research, development, manufacture, and marketing of pharmaceutical products that address unmet medical needs in both niche and larger market segments. We distribute our products on a worldwide basis primarily through a direct sales force in the United States, the United Kingdom (for our oral liquid products), and Israel, and primarily through third-party license and distribution relationships elsewhere. Through a combination of internal research and development, acquisitions, collaborative relationships, and licensing arrangements, Bio-Technology General Corp. ("BTG") has assembled a diverse portfolio of therapeutic products, many of which are currently being marketed, several of which are in registration or clinical trials, and several of which are in pre-clinical development.

BTG was founded in 1980 to develop, manufacture, and market novel therapeutic products. In September 2002, we acquired Rosemont Pharmaceuticals Limited ("Rosemont"), a specialty pharmaceutical company located in the United Kingdom that develops, manufactures, and markets pharmaceutical products in oral liquid form. BTG's overall administration, finance, legal and patent activities, business development, human clinical studies, U.S. sales and marketing activities, quality assurance, and regulatory affairs are primarily coordinated at our headquarters in East Brunswick, New Jersey. Pre-clinical studies, research and development activities, and manufacturing of our biotechnology-derived products are primarily carried out through Bio-Technology General (Israel) Ltd. ("BTG-Israel"), our wholly owned subsidiary in Israel. Development, manufacture, distribution, and sale of our oral liquid products are carried out through Rosemont in the United Kingdom.

Acquisition of Rosemont Pharmaceuticals Limited

On September 30, 2002, BTG, through its wholly owned subsidiary Acacia Biopharma Limited, completed the acquisition of all of the stock of Rosemont Pharmaceuticals Limited, a subsidiary of Akzo Nobel N.V. Rosemont is a leader in the U.K. market for oral liquid formulations of branded non-proprietary drugs. The purchase price (including acquisition costs of approximately $5,421,000) for Rosemont, which was funded from our cash on hand, was approximately $104,544,000, excluding Rosemont's cash balances.

The acquisition has been accounted for under the purchase method of accounting. The aggregate purchase price of $104,544,000 is being allocated based on the estimates of the fair value of the tangible and intangible assets acquired and liabilities assumed, as follows:

in thousands	
Assets acquired:	
Current assets (including cash acquired of $5,268)	$ 10,924
Fixed assets	1,708
Intangibles	80,800
Goodwill	40,080
Liabilities assumed:	
Current liabilities	(4,728)
Deferred tax liabilities	(24,240)
Total purchase price	$104,544

The estimation of the fair value of assets acquired and liabilities assumed was determined by BTG's management based on a preliminary independent appraisal and information currently available. BTG is in the process of completing the evaluation of certain acquired assets, as well as certain intangibles. Accordingly, the allocation of the purchase price is subject to revision. Intangible assets consist primarily of developed products and will be amortized, using the straight-line method, over the estimated useful life of approximately twenty years. The estimation of the useful life of the intangible assets was determined by BTG's management based on a preliminary independent appraisal and information currently available. BTG is in the process of completing the useful life assessment and, accordingly, it is subject to revision.

Intangible assets consist of developed products, trademarks, and several patents and are being amortized, using the straight-line method, over the estimated useful life of approximately twenty years. The estimation of the useful life of the intangible assets was determined by BTG's management based on an independent appraisal and information currently available.

In connection with the acquisition, we entered into a forward contract for the delivery of the £64,000,000 purchase price on September 30, 2002 at a cost of $99,123,200 (representing an exchange rate of $1.5488 per £1). The exchange rate at the acquisition closing date was $1.5614 per £1. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," which prohibits hedge accounting for a hedge of an anticipated business combination, we recorded a gain of approximately $800,000 on the forward contract.

Acquisition of Myelos Corporation

On March 19, 2001, BTG acquired Myelos Corporation ("Myelos"), a privately held biopharmaceutical company focused on the development of novel therapeutics to treat diseases of the nervous system. Under the terms of the acquisition agreement, BTG paid Myelos shareholders $35,000,000 in a combination of cash and stock ($14,000,000 in cash and $21,000,000 through the issuance of approximately 2,344,700 shares of BTG common stock, based on a per share value of $8.9564, representing the average closing price of BTG's common stock for the twenty trading-day period ending one day prior to February 21, 2001, the date the acquisition agreement was executed).

In the event that (i) BTG publicly announces that it will file a New Drug Application ("NDA") related to the use of Prosaptide to treat neuropathic pain or neuropathy, (ii) BTG receives U.S. Food and Drug Administration ("FDA") minutes stating that the clinical data possessed by BTG is sufficient for an NDA filing for the use of Prosaptide to treat neuropathic pain or neuropathy without requiring any further testing, or (iii) BTG initiates preparation of an NDA for Prosaptide for the treatment of neuropathic pain or neuropathy (the date the earliest of the foregoing occurs being the "Payment Trigger Date"), then BTG will pay to the Myelos shareholders an additional $30,000,000, at least approximately $14,000,000 of which must be paid in shares of BTG common stock, valued at the average of the closing prices of BTG common stock during the twenty trading days ending on the Payment Trigger Date, and the remainder can be paid in cash, shares of BTG common stock, or a combination thereof, as determined by BTG in its sole discretion.

In addition, in the event that the FDA approves the sale of Prosaptide for the treatment of neuropathic pain or neuropathy, BTG will pay the Myelos shareholders 15% of the net sales of Prosaptide for the treatment of neuropathic pain or neuropathy during the twelve-month period beginning on the earlier of (i) the twenty-fifth full month after commercial introduction of Prosaptide in the United States for the treatment of neuropathic pain or neuropathy, or (ii) April 1, 2010. At least 50% of this payment must be paid in shares of BTG common stock, valued at the average of the closing prices of BTG common stock during the twenty days ending one day prior to the payment, and the remainder can be paid in cash, shares of BTG common stock, or a combination thereof, as determined by BTG in its sole discretion.

In no event will BTG be obligated to issue in aggregate to the Myelos shareholders more than 10,962,000 shares of BTG common stock. Any amount of the contingent payments that cannot be paid in shares of BTG common stock will instead be paid in shares of BTG's preferred stock. The preferred stock will be non-voting, non-convertible, non-transferable, non-dividend paying (except to the extent a cash dividend is paid on the BTG common stock), with no mandatory redemption for a period of twenty years and one day from the March 19, 2001 closing date of the acquisition, and a right to share in proceeds in liquidation, up to the liquidation amount.

The transaction was treated as a "purchase" for accounting purposes. The purchase price for accounting purposes was approximately $34,387,000 (including acquisition costs of $1,387,000), based on a value per share for the approximately 2,344,700 shares of BTG common stock issued in the acquisition of $8.1172, representing the average closing price of BTG's common stock for the four-day period preceding February 21, 2001, the date the terms of the acquisition were agreed. In connection with the merger and based on an independent valuation, BTG allocated $45,600,000 to in-process research and development projects of Myelos, representing the estimated fair value based on risk-adjusted cash flows of the acquired technology. At the date of the merger, the technology acquired in the acquisition was not fully commercially developed and had no alternative future uses. Accordingly, the value was expensed as of the acquisition date. BTG recorded negative goodwill of $18,914,000 on its balance sheet, primarily because the amount written off as in-process research and development acquired exceeded the purchase price for accounting purposes. During 2001, this negative goodwill was being amortized over its expected useful life of five years. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," amortization of the negative goodwill ceased beginning January 1, 2002, and the balance remaining will be maintained as a deferred credit until it is either netted against the contingent payments or reflected in net income as an extraordinary item should the contingent payments not become due because the technology did not meet the milestones that trigger payment.

BTG allocated values to the in-process research and development based on an independent valuation of the research and development project. The value assigned to these assets was determined by estimating the costs to develop the acquired technology into a commercially viable product, estimating the resulting net cash flows from the product, and discounting the net cash flows to their present value. The revenue projection used to value the in-process research and development was based on estimates of relevant market size and growth factors, expected trends in technology, and the nature and expected timing of new product introductions by BTG and its competitors. The resulting net cash flows from such product are based on management's estimates of cost of sales, operating expenses, and income taxes from such product. BTG believes that the assumptions used in the forecasts were reasonable at the time of the merger. No assurance can be given, however, that the underlying assumptions used to estimate sales, development costs, or profitability, or the events associated with such product will transpire as estimated. For these reasons, actual results may vary from projected results. The most significant and uncertain assumptions relating to the in-process research and development relate to the ability to successfully develop a product and the projected timing of completion of, and revenues attributable to, that product.

Investment in Omrix Biopharmaceuticals, Inc.

In January 2001, in order to obtain a period of exclusivity to negotiate a possible strategic relationship with Omrix Biopharmaceuticals, Inc. ("Omrix"), BTG loaned $2,500,000 to Omrix and agreed to convert the loan into and purchase an additional $2,500,000 of shares of Omrix preferred stock if it did not pursue a relationship. BTG determined not to pursue a strategic relationship with Omrix and, on March 31, 2001, converted the existing loan into and purchased an additional $2,500,000 of shares of Omrix preferred stock, which are convertible into approximately 4.5% of Omrix common stock (on a fully diluted basis). Omrix is a privately held company that develops and markets a unique surgical sealant and a number of immunology products based on blood plasma processing technology. Omrix currently sells its products in Europe, South America, and the Middle East. During the fourth quarter of 2001, BTG determined that the decline in the value of its investment in Omrix was other than temporary and accordingly wrote down the value of this investment by $3,000,000, based on management's evaluation of current market conditions and Omrix's operations and forecasts. The write-down is included as a component of other income (expense), net. Based on the current information available regarding Omrix, management believes the current carrying value of its investment in Omrix is appropriate.

2003 Outlook

Early in 2002, we announced our intention to invest more heavily in research and development and marketing and sales activities and provided guidance that, as a consequence, 2002 earnings would not match those of 2001, although growth in earnings would resume in 2003. BTG anticipates growth in revenues and earnings per share in 2003. In particular, with the transition of Oxandrin to a direct to wholesaler business model (versus selling to Accredo Health Services, Inc. ["Accredo"]), availability, as of October 2002, of the Oxandrin 10-mg tablet strength in addition to the 2.5-mg tablet, as well as the broader focus of the BTG sales force in new areas of potential demand for an effective involuntary weight loss product, and a strong upward trend suggested by recent prescription data, Oxandrin sales are expected to grow. Human growth hormone ("hGH") sales are expected to be less than those of 2002 due to ongoing pricing pressures in Japan, and Delatestryl sales are expected to be less than those of 2002 due to anticipated supply constraints following heavier than expected demand in 2002. Sales of oral liquid pharmaceutical products by Rosemont are anticipated to continue to grow at their historical rates and are expected to make a significant contribution to BTG's 2003 revenues. Contract fees and royalty revenues are expected to approximate their 2002 levels.

Increases in expenses in 2003 compared to 2002 are expected due to BTG's heavy commitment to its pipeline products and associated research and development costs. We anticipate that research and development expense will be approximately 30% of our total revenues. Incremental investment in marketing and sales to maximize the commercial potential of BTG's marketed products in the United States and the United Kingdom is also anticipated. Cost of goods as a percentage of sales is anticipated to grow as a function of product mix, the Rosemont contribution to total product sales, and the validation of BTG's new production facility in Israel. Additionally, amortization of intangibles expense is expected to increase to approximately $4,000,000 on an annual rate, reflecting the full-year impact of the Rosemont acquisition.

Critical Accounting Policies and the Use of Estimates

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. The items in our consolidated financial statements requiring significant estimates and judgments are as follows:

- *Revenue recognition* Product sales are recognized when the product is shipped and collectability is probable, net of discounts, sales incentives, sales allowances, and freight out. Contract fees, which consist mainly of license of marketing and distribution rights and research and development projects, are being recognized over the estimated term of the related agreements. Revenues related to performance milestones are recognized based upon the achievement of the milestone, as defined in the respective agreements, and when collectability is probable. Advance payments received in excess of amounts earned are included in deferred revenue. Royalties are recognized once agreement exists, the sale is made, and the royalty is earned. Other revenues represent funds received by BTG for research and development projects that are partially funded by the Office of the Chief Scientist of the State of Israel ("Chief Scientist"). BTG recognizes revenue upon performance of such funded research.

- *Intangible assets acquired* On September 30, 2002, we acquired Rosemont. The aggregate purchase price of $104,544,000 is being allocated based on the estimates of the fair value of the intangible assets acquired, which was based on a preliminary independent appraisal and information currently available. Intangible assets consist of developed products, trademarks, and several patents and are being amortized, using the straight-line method, over the estimated useful life of approximately twenty years. BTG's management determined the estimation of the useful life of the intangible assets based on independent appraisal and information currently available. BTG is in the process of completing the evaluation of certain acquired assets, as well as certain intangibles and the useful life. Accordingly, the allocation of the purchase price and the useful life are subject to revisions.

- *Investments* From time to time, we invest in non-marketable equity securities for strategic purposes. These investments are carried at cost. We periodically monitor the liquidity progress and financing activities of these entities to determine if impairment write-downs are required. In 2001, we wrote down our investment in Omrix by $3,000,000.

- *In-process research and development acquired* In connection with our acquisition of Myelos in 2001, we allocated $45,600,000 to in-process research and development projects of Myelos, representing the estimated fair value based on risk-adjusted cash flows of the acquired technology. We expensed this value as of the acquisition date because the technology was not fully commercially developed and had no alternative future uses.

- *Income taxes* Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their basis for income tax purposes and the tax effects of net operating loss and tax credit carryforwards. We record valuation allowances to reduce deferred tax assets to the amounts that are more likely than not to be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for valuation allowances and, at December 31, 2002, did not record a valuation allowance against our deferred tax asset. If we determine in the future that we will not be able to realize all or part of our net deferred tax assets, adjustments will be charged to income in the period that we made such determination.

- *Allowance for doubtful accounts* We maintain allowances for doubtful accounts receivable for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

- *Litigation* We are currently involved in certain legal proceedings referred to in Note 8, "Commitments and Contingent Liabilities," of the Notes to Consolidated Financial Statements. We do not believe these legal proceedings will have a material adverse effect on our consolidated financial position, results of operations, or cash flows. However, were an unfavorable ruling to occur in any quarterly period, there exists the possibility of a material impact on the operating results.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. See our audited consolidated financial statements and notes thereto, which begin on page 31 of this Annual Report, that contain accounting policies and other disclosures required by generally accepted accounting principles.

Results of Operations

The following table sets forth, for the fiscal periods indicated, the dollar amount and the percentage of our revenues represented by the items reflected on our consolidated statements of operations.

dollars in thousands

Years ended December 31	2000		2001		**2002**	
Revenues:						
Product sales	$62,149	85.4%	$ 87,106	91.9%	**$ 96,107**	**93.3%**
Contract fees	5,542	7.6	1,656	1.8	**1,804**	**1.8**
Royalties	3,139	4.3	3,817	4.0	**3,891**	**3.8**
Other revenues	1,931	2.7	2,195	2.3	**1,164**	**1.1**
Total revenues	72,761	100.0%	94,774	100.0%	**102,966**	**100.0%**
Expenses:						
Research and development	25,331	34.8%	27,778	29.3%	**32,783**	**31.8%**
Marketing and sales	17,614	24.2	17,006	17.9	**22,143**	**21.5**
General and administrative	12,685	17.4	13,252	14.0	**17,582**	**17.1**
Cost of product sales	9,887	13.6	12,388	13.1	**14,148**	**13.7**
Amortization of intangibles and negative goodwill associated with acquisitions	—	—	(2,961)	(3.1)	**1,013**	**1.0**
Commissions and royalties	1,879	2.6	1,975	2.1	**2,159**	**2.1**
Write-off of in-process research and development acquired	—	—	45,600	48.1	**—**	**—**
Total expenses	67,396	92.6	115,038	121.4	**89,828**	**87.2**
Operating income (loss)	5,365	7.4	(20,264)	(21.4)	**13,138**	**12.8**
Other income (expense), net	7,376	10.1	(4,929)	(5.2)	**1,642**	**1.6**
Income (loss) before income taxes and cumulative effect of change in accounting principle	12,741	17.5	(25,193)	(26.6)	**14,780**	**14.4**
Income tax expense	3,798	5.2	4,733	5.0	**5,063**	**4.9**
Income (loss) before cumulative effect of change in accounting principle	8,943	12.3	(29,926)	(31.6)	**9,717**	**9.5**
Cumulative effect of change in accounting principle	(8,178)	11.2	—	—	**—**	**—**
Net income (loss)	$ 765	1.1%	$(29,926)	(31.6%)	**$ 9,717**	**9.5%**

BTG has historically derived its revenues from product sales as well as from collaborative arrangements with third parties, under which BTG may earn up-front contract fees, may receive funding for additional research (including funding from the Chief Scientist), is reimbursed for producing certain experimental materials, may be entitled to certain milestone payments, may sell product at specified prices, and may receive royalties on sales of product. We anticipate that product sales will constitute the majority of our revenues in the future. Revenues have in the past displayed and will in the immediate future continue to display significant variations due to changes in demand for our products, new product introductions by BTG and its competitors, the obtaining of new research and development contracts and licensing arrangements, the completion or termination of such contracts and arrangements, the timing and amounts of milestone payments, and the timing of regulatory approvals of products.

The following table summarizes, for the fiscal periods indicated, BTG's sales of its commercialized products and their percentage of total product sales:

dollars in thousands Years ended December 31	2000		2001		**2002**	
Oxandrin	$32,187	52%	$47,150	54%	**$45,861**	**48%**
Bio-Tropin	20,584	33	23,863	27	**20,564**	**21**
BioLon	6,117	10	8,227	10	**6,696**	**7**
Delatestryl	2,582	4	7,253	8	**15,595**	**16**
Oral liquid pharmaceutical products	—	—	—	—	**6,346**	**7**
Other	679	1	613	1	**1,045**	**1**
Total	$62,149	100%	$87,106	100%	**$96,107**	**100%**

We believe that our product mix will vary from period to period based on the purchasing patterns of our customers and our focus on: (i) increasing market penetration of our existing products, (ii) expanding into new markets, and (iii) commercializing additional products.

We believe that sales of Oxandrin will continue to constitute a significant portion of our total revenues for the next several years. Accordingly, any factor adversely affecting sales of Oxandrin could have a material adverse effect on our results of operations and profitability and our ability to conduct our business. Quarterly fluctuations in sales of Oxandrin have had a significant impact on our quarterly results of operations. Quarterly sales of Oxandrin in 2000, 2001, and 2002 are set forth in the following table:

dollars in thousands Years ended December 31	2000	2001	**2002**
First quarter	$ 5,009	$16,692	**$ 9,555**
Second quarter	6,403	17,887	**12,329**
Third quarter	10,889	4,575	**13,661**
Fourth quarter	9,886	7,996	**10,316**
Total	$32,187	$47,150	**$45,861**

Until the fourth quarter of 2002, our sales of Oxandrin consisted of sales to Accredo, formerly known as Gentiva Health Services, Inc., our wholesale and retail distributor of Oxandrin in the United States and, beginning in the third quarter of 2000, the Ross Products Division of Abbott Laboratories ("Ross"), which is co-marketing Oxandrin in the long-term-care market. In the fourth quarter of 2002, BTG renegotiated its agreement with Accredo, and BTG now sells Oxandrin directly to wholesalers, and Accredo distributes Oxandrin for BTG on a fee-for-service basis. Accredo will earn management fees from BTG for certain services it will continue to provide, such as warehousing and shipping of product. The transition to the new arrangement, which we anticipate will be completed by the end of March 2003 when Accredo ceases to act as distributor of the 2.5-mg Oxandrin tablets, resulted in sales of Oxandrin decreasing by $3,345,000 in the fourth quarter of 2002 compared to the third quarter of 2002, as Accredo began to reduce its inventory of the 2.5-mg Oxandrin tablet. BTG's sales of Oxandrin in the first quarter of 2003 will be adversely affected by Accredo's working down of its inventory of the 2.5-mg tablets.

The increase in Oxandrin sales in each of the last three quarters of 2000 was due to Accredo's completion, in May 2000, of the Oxandrin inventory reduction that Accredo began in April 1999 as a result of a slowing in the rate of increase in Oxandrin prescriptions. The increase in Oxandrin sales during the first half of 2001 was due to: (i) the commencement, in September 2000, of sales by Ross for the long-term-care market for the treatment of patients with involuntary weight loss, including stocking activity by wholesalers in connection with the launch of this product in the long-term-care market, (ii) stocking by certain wholesalers in anticipation of a price increase, (iii) increased purchases by Accredo following its completion, in May 2000, of a reduction in the amount of Oxandrin inventory it carried, which reduction began in April 1999, and (iv) increased wholesaler sales of Oxandrin by Accredo.

Upon completion of its inventory reduction in May 2000, Accredo began to purchase, on a monthly basis, an amount of Oxandrin equal to the average end-user (i.e., wholesaler) sales during the preceding three months. However, because of the significant increase in Oxandrin purchases by wholesalers in the first quarter of 2001 in anticipation of a price increase and in connection with the launch of Oxandrin into the long-term-care market, Accredo's purchases of Oxandrin in the second quarter were higher than the levels of its sales of Oxandrin to wholesalers in that period. As a result, Accredo's inventory of Oxandrin increased beyond the desired level. Accordingly, BTG and Accredo amended their distribution arrangement, effective August 2001, to provide for reduced purchases of Oxandrin until Accredo's inventory was reduced to desired levels and thereafter to ensure that sales of Oxandrin by BTG to Accredo more accurately reflected end-user demand. As a result, sales of Oxandrin in the second half of 2001 were $22,008,000 lower than in the first half of 2001 and $8,204,000 lower than in the second half of 2000.

Since BTG's launch of Oxandrin in December 1995 through December 2000, a significant portion of Oxandrin sales has been for treatment of patients suffering from AIDS-related weight loss. However, the rate of growth in the AIDS-related weight loss market has slowed substantially, and there can be no assurance that it will continue to grow in the future. Our inability to continue to increase our sales in the AIDS-related weight loss market or to expand into other markets could have a material adverse effect on our business. Oxandrin sales experienced rapid growth in December 2000 and the first half of 2001 in large part as a result of the commencement by Ross of the marketing of Oxandrin for the treatment of involuntary weight loss in the long-term-care market, which represented approximately 15% of Oxandrin wholesaler to end-user sales in both 2001 and 2002. Although Oxandrin prescriptions increased 22% in 2002 compared to 2001 and 26.5% in 2001 compared to 2000, to date the average prescription written for the long-term-care market involves a lower dose of Oxandrin than the average prescription written for the AIDS market and, therefore, the rate of growth in Oxandrin sales will be less than the rate of growth in prescriptions. Ross has the right to terminate our Oxandrin co-marketing agreement at any time upon six months' notice. If Ross elects to do so, our Oxandrin sales could be adversely affected until we are able to replace the Ross sales force, which we may not be able to do successfully. BTG has the right to terminate the agreement at the end of 2003 if Ross does not meet specified sales levels. There can be no assurance that demand for Oxandrin will continue to increase.

Reductions in wholesaler purchases of Oxandrin from Accredo in the second, third, and fourth quarters of 2001 and significantly reduced purchases of Oxandrin by Accredo in the second half of 2001 adversely affected the growth in BTG's product sales and revenues and BTG's results of operations in the second half of 2001. Because purchases by wholesalers fluctuate from month to month and quarter to quarter based on their own operating strategies (including desired levels of inventories, purchases by their customers, and stocking in advance of anticipated price increases), BTG's sales will fluctuate from quarter to quarter.

The following table summarizes, for the fiscal periods indicated, BTG's U.S. and international product sales and their percentage of total product sales:

dollars in thousands

Years ended December 31	2000		2001		**2002**	
United States	$34,635	56%	$55,441	64%	**$63,382**	**66%**
International	27,514	44	31,665	36	**32,725**	**34**
Total	$62,149	100%	$87,106	100%	**$96,107**	**100%**

Domestic sales as a percentage of total product sales have fluctuated due primarily to a reduction in purchases of Oxandrin by BTG's U.S. distributor from April 1999 through May 2000 and increased sales of Oxandrin to BTG's U.S. distributor in the second half of 2000 and the first half of 2001.

Comparison of Years Ended December 31, 2000, 2001, and 2002

Revenues in 2002 increased 9% to $102,966,000 from $94,774,000 in 2001, which represented a 30% increase from $72,761,000 in 2000. Product sales, net of discounts, sales incentives, sales allowances, and freight out, increased 10% in 2002 to $96,107,000 from $87,106,000 in 2001, which itself was a 40% increase from 2000 product sales of $62,149,000. The changes in revenues between 2000, 2001, and 2002 were primarily driven by changes in product sales, principally Oxandrin. Product sales in 2002 include $6,346,000 of sales of oral liquid pharmaceutical products resulting from our acquisition of Rosemont on September 30, 2002.

Sales of Oxandrin in 2002, 2001, and 2000 were $45,861,000, $47,150,000, and $32,187,000, respectively, representing 48%, 54%, and 52%, respectively, of BTG's total product sales in those periods. Sales of Oxandrin to Accredo in 2002, 2001, and 2000 were $30,030,000, $38,775,000, and $30,885,000, net, respectively, representing 65%, 82%, and 96%, respectively, of BTG's total sales of Oxandrin. Sales of Oxandrin in 2002 decreased by $1,289,000, or 3%, from 2001 sales as a result of our transition to a direct to wholesaler business model rather than selling to Accredo, which would then resell to distributors. In 2001, sales of Oxandrin increased $14,963,000, or 46%, from 2000 sales. Sales of Oxandrin increased $23,167,000 in the first half of 2001 due to: (i) the commencement, in September 2000, of sales by Ross for the long-term-care market for the treatment of patients with involuntary weight loss, including stocking activity by wholesalers in connection with the launch of this product in the long-term-care market; (ii) stocking by certain wholesalers in anticipation of a price increase; (iii) increased purchases by Accredo following its completion, in May 2000, of a reduction in the amount of Oxandrin inventory it carried, which reduction began in April 1999; and (iv) increased wholesaler sales of Oxandrin by Accredo. Sales of Oxandrin in the second half of 2001 decreased $8,204,000 from the comparable period in 2000 due to Accredo's increased purchases of Oxandrin in the second half of 2000 following completion of its inventory reduction and decreased purchases in the second half of 2001 to reduce inventory.

Sales of hGH in 2002, 2001, and 2000 were $20,564,000, $23,863,000, and $20,584,000, respectively, representing 21%, 27%, and 33%, respectively, of BTG's total product sales in those periods. Sales of hGH in 2002 decreased by $3,299,000, or 14%, from 2001 sales due to pricing pressures in Japan, partially offset by an initial sale to Teva Pharmaceutical Industries Ltd. ("Teva"). Sales of hGH increased in 2001 by $3,279,000, or 16%, over 2000 sales, primarily due to increased sales to JCR Pharmaceuticals Co., Ltd. ("JCR") and the Ferring Group ("Ferring"). Sales of hGH to JCR in 2002, 2001, and 2000 were $12,331,000, $16,292,000, and $12,975,000, respectively, representing 13%, 19%, and 21%, respectively, of BTG's total product sales in those periods and 60%, 68%, and 63%, respectively, of BTG's total hGH sales in those periods. Sales of hGH to Ferring were $5,453,000, $5,889,000, and $4,812,000 in 2002, 2001, and 2000, respectively, representing 6%, 7%, and 8%, respectively, of BTG's total product sales in those periods and 27%, 25%, and 23%, respectively, of BTG's total hGH sales in those periods.

Sales of Delatestryl in 2002 increased by $8,342,000, or 115%, over 2001 sales, which sales increased by $4,671,000, or 181%, over 2000 levels, when we had no sales of Delatestryl in the second and third quarters. The increase in Delatestryl sales was due to the FDA stopping the production of a competing generic injectable testosterone product used to treat men with hypogonadism (testosterone deficiency) in 1998, which product has not to date been reintroduced.

BioLon sales in 2002 decreased $1,530,000, or 19%, from 2001 levels, after 2001 sales increased $2,110,000, or 34%, over 2000 sales. In the first quarter of 2000, we halted product shipments of BioLon to the United States pending FDA approval of a supplemental application relating to an upgrade in BTG's manufacturing process to conform it to a higher standard of quality implemented by BTG. BTG resumed shipments to the United States in the first quarter of 2001, although shipments again stopped in the fourth quarter of 2001 as the FDA was not able to inspect the new manufacturing facility of BTG's contract sterilizer for BioLon due to the violence in Israel in recent years until July 2002. Shipments resumed in September 2002 following FDA approval.

Contract fees for the year ended December 31, 2002 were $1,804,000, which includes $1,646,000 of contract fees received in prior periods but recognized in 2002 in accordance with Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements." For the year ended December 31, 2001, contract fees were $1,656,000, which represent contract fees received in prior periods but recognized in 2001 in accordance with SAB No. 101. For the year ended December 31, 2000, contract fees, which consist of licensing and option to license fees, amounting to $5,542,000, or 8%, of total revenues, were earned from certain of BTG's collaborative partners. Of the contract fees earned in 2000, $2,500,000, or 45% of total contract fees, was earned as a milestone payment under BTG's strategic alliance with Teva focusing on the development and global commercialization of several generic recombinant therapeutic products and the license of distribution rights in the United States for BTG's hGH, and $1,475,000, or 27% of total contract fees, was earned in respect of the Bio-Hep-B vaccine. Under SAB No. 101, contract fees in 2000 include $853,000 of contract fees paid in prior periods, or 15% of total contract fees, as well as $313,000, or 6% of total contract fees, of the $5,000,000 received in 2000 in respect of Arthrease; the remaining $4,687,000 of this fee has been deferred in accordance with SAB No. 101.

Royalties in 2002, 2001, and 2000 consist mainly of net royalties in respect of the Mircette product in the amount of $3,891,000, $3,817,000, and $3,139,000, respectively.

Other revenues consist primarily of funding from the Chief Scientist, which represented 90%, 100%, and 81% of other revenues in the years ended December 31, 2002, 2001, and 2000, respectively.

Research and development expense was $32,783,000, $27,778,000, and $25,331,000 for the years ended December 31, 2002, 2001, and 2000, respectively. The increase in research and development expenditures in 2002 compared to 2001 resulted primarily from the addition of research and development activities for Prosaptide following the acquisition of Myelos in March 2001, increased patent related expenses, increased clinical activities, and Rosemont's development expenses following the acquisition. The increase in research and development expenditures in 2001 compared to 2000 resulted mainly from the increase in research and development personnel and legal fees related to patent maintenance and patent interference proceedings, as well as the addition of research and development activities for Prosaptide following the acquisition of Myelos, partially offset by decreased expenses in 2001 compared to 2000 associated with developing alternate manufacturing sources for Oxandrin and for a new tablet formulation and decreased compensation charges arising from modification of the periods of vesting and exercisability of certain stock option awards to certain employees and former employees made in connection with the termination of their employment and post-employment consulting arrangements.

Marketing and sales expense was $22,143,000, $17,006,000, and $17,614,000 in the years ended December 31, 2002, 2001, and 2000, respectively. These expenses primarily related to the U.S. sales and marketing force that BTG established principally in the second half of 1995 and during 1996 to promote distribution of Oxandrin in the United States and, beginning with the fourth quarter of 2002, Rosemont's sales and marketing force in the United Kingdom. The significant increase in marketing and sales expense in 2002 was due to increased promotion and marketing costs, as well as increased compensation and training costs due to BTG's expansion of its field force, as BTG sought to maximize Oxandrin's potential and growth, and the inclusion of $1,339,000 of Rosemont's expenses, partially offset by decreased incentive compensation costs. The decrease in marketing and sales expense in 2001 compared to 2000 derived mainly from decreased advertising, promotional, and market research activities, partially offset by increased compensation costs.

General and administrative expense was $17,582,000, $13,252,000, and $12,685,000 in the years ended December 31, 2002, 2001, and 2000, respectively. The increase in general and administrative expense in 2002 compared to 2001 was principally due to increased compensation costs, substantial audit fees incurred in 2002 in connection with the reaudit of BTG's financial statements, and inclusion of Rosemont's expenses following the acquisition, partially offset by decreased merger and acquisition activities in 2002 and higher consulting fees in 2001. General and administrative expense for 2002 includes a $1,100,000 non-recurring pension expense incurred in connection with the acquisition of Rosemont. The increase in 2001 compared to 2000 was primarily due to increased compensation costs, partially offset by a decrease in legal fees (litigation) as compared to 2000, when legal fees increased primarily due to the reactivation, in the fourth quarter of 1998, of BTG's declaratory judgment action against Genentech, Inc., in respect of BTG's human growth hormone product in the United States.

Cost of product sales was $14,148,000, $12,388,000, and $9,887,000 in the years ended December 31, 2002, 2001, and 2000, respectively. Cost of product sales as a percentage of product sales was 15%, 14%, and 16% in 2002, 2001, and 2000, respectively. Cost of product sales in 2002 increased in absolute terms and as a percentage of product sales due to increased sales, a change in the mix of products as compared to 2001 and, in the fourth quarter of 2002, the addition of Rosemont's products, which have a higher cost of goods than most of the other BTG products. Cost of product sales for 2002 includes $1,272,000 of costs related to the Rosemont products. Cost of product sales in 2001 increased in absolute terms as a result of increased product sales, but decreased as a percentage of product sales, primarily as a result of Oxandrin accounting for a significant portion of the increase in product sales. Oxandrin has a relatively low cost of manufacture as a percentage of product sales, while BioLon has the highest cost to manufacture as a percentage of product sales. Cost of product sales as a percentage of product sales varies from year to year and quarter to quarter depending on the quantity and mix of products sold.

Amortization of intangibles and negative goodwill associated with acquisitions In connection with the acquisition of Myelos, BTG recorded negative goodwill of $18,989,000 on its balance sheet, primarily because the amount written off as in-process research and development acquired exceeded the purchase price for accounting purposes. During 2001, this negative goodwill was being amortized over its expected useful life of five years. In accordance with SFAS No. 142, amortization of the negative goodwill ceased beginning January 1, 2002, and the balance remaining will be maintained as a deferred credit until it is either netted against the contingent payments or reflected in net income as an extraordinary item, should the contingent payments not become due because the technology did not meet the milestones that trigger payment. In connection with the acquisition of Rosemont, we recorded intangibles of $80,800,000, consisting of trademarks, patents, and developed products. These intangibles are being amortized, using the straight-line method, over the estimated useful life of approximately twenty years. We recorded $1,013,000 of amortization of these intangibles in the fourth quarter of 2002, and expect that we will record $4,050,000 of annual amortization of these intangibles.

Commissions and royalties were $2,159,000, $1,975,000, and $1,879,000 in the years ended December 31, 2002, 2001, and 2000, respectively. These expenses consist primarily of royalties to entities from which BTG licensed certain of its products and to the Chief Scientist.

Write-off of in-process research and development acquired In 2001, BTG wrote off $45,600,000 as in-process research and development acquired relating to the acquisition of Myelos. In connection with the acquisition, BTG allocated $45,600,000 to in-process research and development projects of Myelos, representing the estimated fair value based on risk-adjusted cash flows of the acquired technology based on an independent valuation. At the date of the merger, the technology acquired in the acquisition was not fully commercially developed and had no alternative future uses. Accordingly, the value was expensed as of the acquisition date.

Other income (expense), net, which was $1,642,000, ($4,929,000), and $7,376,000 in the years ended December 31, 2002, 2001, and 2000, respectively, includes investment income, net, finance expense, and realized and unrealized losses on investments. Investment income, net, was $2,823,000, $7,302,000, and $7,376,000 in the years ended December 31, 2002, 2001, and 2000, respectively. In 2002, investment income, net, decreased mainly due to lower yields and lower cash and short-term investment balances in 2002 resulting from the acquisition of Rosemont, partially offset by an $800,000 realized gain from the forward contract for the delivery of £64,000,000 entered into in connection with the Rosemont acquisition. SFAS No. 133 prohibits hedge accounting for a hedge of an anticipated business combination. In 2001, investment income, net, decreased slightly, as the total of cash, cash equivalents, and short-term investments decreased due to the use of cash to acquire Myelos, to fund construction of BTG's new manufacturing facility, and to purchase shares of Omrix, partially offset by cash flow from operations, proceeds from the exercise of options, and proceeds from a $20,000,000 loan borrowed to finance construction of BTG's new manufacturing facility in Israel. We recognized realized and unrealized losses on investment, net of $1,181,000 in 2002. In 2001, we recognized realized and unrealized capital losses of $9,231,000 on short-term investments that were liquidated during December 2001 and early 2002. During the fourth quarter of 2001, we determined that the decline in the value of our investment in Omrix was other than temporary and, accordingly, wrote down the value of this $5,000,000 investment by $3,000,000 based on management's evaluation of current market conditions and Omrix's operations and forecasts.

Income taxes Provision for income taxes for the years ended December 31, 2002, 2001, and 2000 was $5,063,000, $4,733,000, and $3,798,000, respectively, representing approximately 34.3%, 27.1% (on a pro forma basis excluding the write-off of in-process research and development acquired and amortization of negative goodwill, which are not taken into account in computing income taxes), and 29.8% of income before income taxes. BTG's consolidated tax rate differs from the statutory rate because of Israeli tax benefits, research and experimental tax credits, state and local taxes, and similar items that affect the tax rate. In 2001, BTG recorded a provision for additional taxes of $1,530,000 as a result of a tax audit that BTG-Israel was undergoing covering the 1997 through 2000 tax years. The tax audit was settled in the second quarter of 2002, and an additional $519,000 of tax was accrued at that time.

Earnings per common share BTG had approximately 1.2 million additional basic weighted average shares outstanding for the year ended December 31, 2002 as compared to the same period in 2001, and had approximately 2.9 million additional basic weighted average shares outstanding for the year ended December 31, 2001 as compared to the same period in 2000. The increased number of basic shares in both 2001 and 2002 was primarily the result of the issuance throughout 2001 of shares upon the exercise of options, the issuance throughout 2001 and 2002 of shares pursuant to our employee stock purchase plan, and the issuance of approximately 2.3 million shares to the former shareholders of Myelos in March 2001. For 2001, diluted weighted average shares outstanding does not include dilutive securities because the effect would be anti-dilutive.

Cumulative effect of change in accounting principle Effective January 1, 2000, BTG adopted SAB No. 101. As a result, BTG changed the way it recognizes revenue from contract fees for the license of marketing and distribution rights where the consideration is a one-time non-refundable payment. Prior to the issuance of SAB No. 101, BTG recorded revenues from the license of marketing and distribution rights when the rights were licensed and/or when these payments were received. Effective January 1, 2000, BTG recorded a cumulative effect of a change in the accounting principle related to contract revenues recognized in prior years in the amount of $12,558,000, net of income taxes of $4,380,000, of which $1,166,000 was recognized as contract fee revenues in 2000. Contract fee revenues are now being recognized over the estimated term of the related agreements.

Liquidity and Capital Resources

At December 31, 2002, our working capital was $29,059,000 as compared to $139,472,000 at December 31, 2001. The decrease in working capital at December 31, 2002 was primarily due to the use of $95,954,000 to acquire Rosemont and an increase in accounts payable and other current liabilities, partially offset by an increase in accounts receivable.

Our cash flows have fluctuated significantly due to the impact of net income, capital spending, working capital requirements, the issuance of common stock, and other financing activities. BTG expects that cash flows in the near future will be primarily determined by the levels of net income, working capital requirements, and financings, if any, undertaken by BTG. Cash, excluding short-term investments, (decreased) increased by $(63,240,000), $49,098,000, and $7,650,000, in the years ended December 31, 2002, 2001, and 2000, respectively. Cash provided by operating activities was $9,194,000, $37,760,000, and $15,267,000 in the years ended December 31, 2002, 2001, and 2000, respectively. Net income (loss) was $9,717,000, $(29,926,000), and $765,000 in the same periods, respectively.

In 2002, net cash provided by operating activities was less than net income, primarily as a result of increased accounts receivable, inventories, prepaid expenses, and other current assets and deferred income taxes of $8,265,000, $1,202,000, $1,284,000, and $837,000, respectively, and deferred revenues of $1,553,000, partially offset by increased accounts payable in the amount of $7,541,000, depreciation and amortization, amortization of intangible assets associated with acquisitions, and a provision for inventory reduction in connection with the validation of a new manufacturing site in the United States in the amounts of $2,701,000, $1,013,000, and $976,000, respectively.

In 2001, we had net cash provided by operating activities despite the net loss, mainly due to the write-off of in-process research and development acquired of $45,600,000, a decrease in accounts receivable of $14,572,000, an unrealized loss on investments, net, of $8,963,000, an increase in accounts payable of $5,178,000, depreciation and amortization of $2,937,000, a realized loss on the sale of short-term investments, net, of $1,735,000, and compensation expense of $1,024,000 resulting from the modification of options previously granted, partially offset by an increase in inventories of $3,875,000, an increase in deferred income tax of $3,957,000, amortization of negative goodwill associated with acquisitions of $2,961,000, and deferred revenues of $1,656,000.

In 2000, net cash provided by operating activities was greater than net income, mainly due to the cumulative effect of the accounting change resulting from the adoption of SAB No. 101, and consisted of $8,178,000 (net of income taxes), deferred revenues of $3,834,000, depreciation and amortization of $2,861,000, and compensation expense of $1,592,000 resulting from the modification of options previously granted, partially offset by an increase in inventories and accounts receivable of $1,256,000 and $973,000, respectively.

Net cash (used in) provided by investing activities was $(73,228,000), $3,651,000, and $(37,401,000) in the years ended December 31, 2002, 2001, and 2000, respectively. Net cash (used in) provided by investing activities included capital expenditures of $15,546,000, $23,974,000, and $10,913,000 in these periods, respectively, consisting of approximately $12,138,000, $21,758,000, and $8,950,000, respectively, for the purchase and construction of a new manufacturing facility, with the remainder in all periods primarily for laboratory and manufacturing equipment and infrastructure. In 2002, net cash used in investing activities also includes the $95,954,000, net, used to acquire Rosemont. In 2001, net cash used in investing activities also includes the $5,000,000 investment in Omrix and $15,603,000, net, used in connection with the acquisition of Myelos. The remainder of the net cash used in investing activities, in all periods, was primarily for purchases and sales of short-term investments.

Net cash provided by financing activities was $517,000, $7,687,000, and $29,784,000 in the years ended December 31, 2002, 2001, and 2000, respectively. Cash from financing activities in 2002 and 2001 consisted of net proceeds from issuances of common stock of $1,751,000 and $7,687,000, respectively. Net proceeds from the sale of common stock resulted mainly from option exercises in 2001 and, in both periods, the issuances of stock pursuant to our employee stock purchase plan. In 2002, we repaid $1,234,000 of long-term debt, principally borrowings under our credit facility that we used to finance a portion of the construction of our new manufacturing facility in Israel. Cash flows from financing activities in 2000 were primarily affected by long-term borrowings of $20,000,000 and proceeds from the issuance of common stock of $9,784,000.

In April 1999, BTG purchased a manufacturing facility in Israel for approximately $6,500,000 (including local taxes and legal fees). Construction of a modern biologics production facility designed to meet FDA current Good Manufacturing Practice requirements for biologics and devices was completed at the end of 2001, and validation has commenced and is expected to be completed in the second half of 2003. BTG will then commence the process validation for products manufactured in the existing facility to be transferred to the new facility. Production of these products cannot be relocated to the new facility until the new facility has received all necessary regulatory approvals, which BTG anticipates will occur during the period from the end of 2003 through the end of 2004, depending on product and territory. Through December 31, 2002, BTG has spent approximately $42,000,000 to complete construction of the production facility (including capitalized interest but excluding the cost of purchasing the facility and post-completion validation), and expects to spend approximately $7,000,000 to complete validation activities, of which approximately $4,000,000 has been expended through December 31, 2002. In June 2000, BTG-Israel entered into a $20,000,000 credit facility with Bank Hapoalim B.M. to finance a portion of the cost of completing its new manufacturing facility. Loans under the credit facility bear interest at the rate of libor plus 1%. The credit facility is secured by the assets of BTG-Israel and has been guaranteed by BTG. At December 31, 2002, BTG had outstanding long-term borrowings of $18,889,000 under the credit facility, of which $6,667,000 is due in each of 2003 and 2004, with the remaining $5,555,000 due in 2005. Borrowings are repaid monthly in equal installments.

We believe that our cash resources as of December 31, 2002, together with anticipated product sales, will be sufficient to fund our ongoing operations for the foreseeable future. There can, however, be no assurance that product sales will occur as anticipated, that current agreements with third-party distributors of our products will not be canceled, that the Chief Scientist will continue to provide funding at current levels or at all, that we will not use a substantial portion of our cash resources to acquire businesses, products, and/or technologies, or that unanticipated events requiring the expenditure of funds will not occur. The satisfaction of BTG's future cash requirements will depend in large part on the status of commercialization of BTG's products, BTG's ability to enter into additional research and development and licensing arrangements, and BTG's ability to obtain additional equity and debt financing, if necessary. There can be no assurance that BTG will be able to obtain additional funds or, if such funds are available, that such funding will be on favorable terms. BTG continues to seek additional collaborative research and development and licensing arrangements in order to provide revenue from sales of certain products and funding for a portion of the research and development expenses relating to the products covered, although there can be no assurance that it will be able to obtain such agreements. Below is a table that presents our contractual obligations and commitments at December 31, 2002. We had no capital lease obligations or unconditional purchase commitments as of that date.

Payments Due by Period

in thousands Contractual obligations	Total	Less than 1 year	1–3 years	4–5 years	After 5 years	Undetermined[1]
Long-term debt	$18,889	$6,667	$12,222	$ —	$ —	$ —
Operating leases	21,450	3,176	5,749	3,455	9,070	—
Other long-term obligations[1]	2,890	—	—	—	—	2,890
Total contractual cash obligations	$43,229	$9,843	$17,971	$3,455	$9,070	$2,890

1. Consists of severance benefits payable under Israeli law. Because these benefits are paid only upon termination of employment, it is not possible to allocate the liability across future years.

BTG applies to the Chief Scientist annually for research and development funding for its various projects for the coming year. The projects and amount funded each year are within the sole discretion of the Chief Scientist. We are currently in discussions with the Chief Scientist about whether it will continue to fund some of our research and development activities, and we cannot assure you that the Chief Scientist will continue to provide funding to us at the same levels or at all. BTG is obligated to pay royalties to the Chief Scientist for products resulting from research and development partially funded by the Chief Scientist. These royalties range from 3% to 5% on commercial sales, if any, of these products if produced in Israel up to the amount so funded, and 4% to 6% of commercial sales, if any, if these products are produced outside Israel up to 120% to 300% of the amount so funded. BTG has received aggregate funding from the Chief Scientist of $22,131,000 through December 31, 2002 (including participation for projects that will not have future sales), and has paid aggregate royalties to the Chief Scientist totaling $4,011,000 through December 31, 2002.

At December 31, 2002, the Company had employment agreements with seven senior officers. Under these agreements, the Company has committed to total aggregate base compensation per year of approximately $2,117,000 plus other normal customary fringe benefits and bonuses. These employment agreements generally have a term of three years and are automatically renewed for successive one-year periods unless either party gives the other notice of non-renewal.

New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement is effective for fiscal years beginning after June 15, 2002. We are currently assessing the impact of this new standard, although we do not expect it to affect our results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. SFAS No. 146 will be applied to exit or disposal activities after December 31, 2002 and is not expected to have a material effect on BTG's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure: an amendment of FASB Statement No. 123," to provide alternative transition methods for a voluntary change to the fair-value-based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," to require prominent disclosures in annual financial statements about the method of accounting for stock-based employee compensation and the pro forma effect on reported results of applying the fair-value-based method for entities that use the intrinsic value method of accounting. The pro forma effect disclosures are also required to be prominently disclosed in interim period financial statements. This statement is effective for financial statements for fiscal years ending after December 15, 2002 and is effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002, with earlier application permitted. BTG does not plan a change to the fair-value-based method of accounting for stock-based employee compensation.

In November 2002, FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN No. 45"), was issued. FIN No. 45 requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee. BTG previously did not record a liability when guaranteeing obligations unless it became probable that BTG would have to perform under the guarantee. FIN No. 45 applies prospectively to guarantees BTG issues or modifies subsequent to December 31, 2002, but has certain disclosure requirements effective for interim and annual periods ending after December 15, 2002. BTG has not yet determined the effects of FIN No. 45 on its financial statements. Disclosures required by FIN No. 45 are included in the accompanying financial statements.

Quantitative and Qualitative Disclosures about Market Risk

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices, and equity prices. To date, our exposure to market risk has been limited. We do not currently hedge any market risk, although we may do so in the future. We do not hold or issue any derivative financial instruments for trading or other speculative purposes. In early 2002, BTG purchased forward contracts in the amount of $3,000,000 to hedge part of its commitments in Israeli shekels, primarily salaries, by locking in the shekel/U.S. dollar exchange rate, which had become more volatile in late 2001. All of these contracts matured by July 1, 2002.

In connection with the acquisition of Rosemont, we entered into a forward contract for the delivery of the £64,000,000 purchase price on September 30, 2002 at a cost of $99,123,200 (representing an exchange rate of $1.5488 per £1). The exchange rate at the acquisition closing date was $1.5614 per £1. In accordance with SFAS No. 133, which prohibits hedge accounting for a hedge of an anticipated business combination, we recorded a gain of approximately $800,000 on the forward contract.

Borrowings under our $20,000,000 credit facility bear interest at a floating rate, and we are therefore impacted by changes in prevailing interest rates. A 100-basis point increase in market interest rates on the $18,889,000 outstanding under this facility at December 31, 2002 would result in an increase in our annual interest expense of $188,890. Because these borrowings relate to the construction of our new facility, which is not yet ready for its intended use, interest expense is currently being capitalized.

Our interest-bearing assets consist of cash and cash equivalents and short-term investments, which currently consist primarily of investments in commercial paper and time deposits. Our interest income is sensitive to changes in the general level of interest rates, primarily U.S. interest rates, and other market conditions.

As a result of our operations in Israel and the United Kingdom, we are subject to currency exchange rate fluctuations that can affect our results of operations. We manage our Israeli operations with the objective of protecting against any material net financial loss in U.S. dollars from the impact of Israeli inflation and currency devaluations on its non-U.S. dollar assets and liabilities. The cost of our operations in Israel, as expressed in dollars, is influenced by the extent to which any increase in the rate of inflation in Israel is not offset (or is offset on a lagging basis) by a devaluation of the Israeli shekel in relation to the U.S. dollar. To the extent that expenses in shekels exceed BTG-Israel's revenues in shekels (which to date have consisted primarily of research funding from the Chief Scientist and product sales in Israel), the devaluations of Israeli currency have been and will continue to be a benefit to BTG's financial condition. However, should BTG-Israel's revenues in shekels exceed its expenses in shekels in any material respect, the devaluation of the shekel will adversely affect BTG's financial condition. Further, to the extent the devaluation of the shekel with respect to the U.S. dollar does not substantially offset the increase in the costs of local goods and services in Israel, BTG's financial results will be adversely affected as local expenses measured in U.S. dollars will increase.

Market for Common Equity and Related Stockholder Matters

BTG's common stock is quoted on the National Association of Securities Dealers Automated Quotation System ("Nasdaq") National Market under the symbol BTGC. The following table sets forth, for the periods indicated, the high and low sale prices per share of BTG's common stock from January 1, 2001 through December 31, 2002 as reported by the Nasdaq National Market.

	2001		**2002**	
	High	Low	**High**	**Low**
First quarter	$ 9.66	$ 5.96	**$ 9.00**	**$ 4.65**
Second quarter	13.39	5.05	**6.26**	**4.10**
Third quarter	12.86	5.50	**6.05**	**2.50**
Fourth quarter	8.68	6.89	**4.88**	**1.95**

The number of stockholders of record of our common stock on March 17, 2003 was approximately 1,250.

We have never declared or paid a cash dividend on our common stock, and we do not expect that cash dividends will be paid to the holders of our common stock in the foreseeable future.

Report of Independent Certified Public Accountants

To the Board of Directors and Stockholders of Bio-Technology General Corp.

We have audited the accompanying consolidated balance sheet of Bio-Technology General Corp. and subsidiaries as of December 31, 2002, and the related statements of operations, changes in stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audit. The consolidated financial statements of Bio-Technology General Corp. and subsidiaries as of December 31, 2001 and for the years ended December 31, 2001 and 2000 were audited by other auditors. The report of those auditors, dated September 20, 2002, on those consolidated financial statements, included an explanatory paragraph that described the change in the Company's method of revenue recognition in 2000 for certain up-front non-refundable fees discussed in Note 1.j. to the consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2002 consolidated financial statements referred to above present fairly, in all material respects the consolidated financial position of Bio-Technology General Corp. and subsidiaries as of December 31, 2002, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1.i. to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets ("SFAS 142")," on January 1, 2002.

Grant Thornton LLP

GRANT THORNTON LLP
New York, New York
February 14, 2003

Consolidated Balance Sheets

in thousands, except share data

December 31	2001	**2002**
## Assets		
Current assets:		
Cash and cash equivalents	$ 75,451	**$ 12,211**
Short-term investments	43,473	**4,336**
Accounts receivable, net	24,538	**35,764**
Inventories	14,140	**16,612**
Deferred income taxes	5,079	**4,176**
Prepaid expenses and other	1,167	**2,829**
Total current assets	163,848	**75,928**
Property and equipment, net	51,059	**66,596**
Intangible assets, net	266	**79,878**
Goodwill	—	**40,080**
Deferred income taxes	14,687	**16,380**
Severance pay funded	2,385	**2,783**
Other assets (including restricted cash of $1,280 in 2002)	2,841	**3,786**
Total assets	$235,086	**$285,431**
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable (including income tax payable of $7,006 in 2001 and $5,464 in 2002)	$ 10,328	**$ 21,618**
Deferred revenues	1,646	**1,557**
Current portion of long-term debt	1,234	**6,674**
Other current liabilities	11,168	**17,020**
Total current liabilities	24,376	**46,869**
Long-term debt	18,896	**12,222**
Deferred revenues	13,092	**11,628**
Severance pay	5,229	**5,673**
Negative goodwill	15,953	**16,028**
Deferred income taxes	—	**23,936**
Commitments and contingent liabilities (Note 8)		
Stockholders' equity:		
Preferred stock — $.01 par value; 4,000,000 shares authorized; no shares issued	—	**—**
Common stock — $.01 par value; 150,000,000 shares authorized; issued: 58,260,000 in 2001; 58,733,000 in 2002	582	**587**
Additional paid in capital	212,408	**214,224**
Accumulated deficit	(55,570)	**(45,853)**
Accumulated other comprehensive income	120	**117**
Total stockholders' equity	157,540	**169,075**
Total liabilities and stockholders' equity	$235,086	**$285,431**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Operations

in thousands, except per share data

Years ended December 31	2000	2001	**2002**
Revenues:			
Product sales, net	$ 62,149	$ 87,106	**$ 96,107**
Contract fees	5,542	1,656	**1,804**
Royalties	3,139	3,817	**3,891**
Other revenues	1,931	2,195	**1,164**
	72,761	94,774	**102,966**
Expenses:			
Research and development	25,331	27,778	**32,783**
Marketing and sales	17,614	17,006	**22,143**
General and administrative	12,685	13,252	**17,582**
Cost of product sales	9,887	12,388	**14,148**
Amortization of intangibles and negative goodwill associated with acquisitions	—	(2,961)	**1,013**
Commissions and royalties	1,879	1,975	**2,159**
Write-off of in-process research and development acquired	—	45,600	**—**
	67,396	115,038	**89,828**
Operating income (loss)	5,365	(20,264)	**13,138**
Other income (expense), net	7,376	(4,929)	**1,642**
Income (loss) before income taxes and cumulative effect of change in accounting principle	12,741	(25,193)	**14,780**
Income tax expense	3,798	4,733	**5,063**
Income (loss) before cumulative effect of change in accounting principle	8,943	(29,926)	**9,717**
Cumulative effect of change in accounting principle, net of income taxes of $4,380	(8,178)	—	**—**
Net income (loss)	$ 765	$(29,926)	**$ 9,717**
Earnings (Loss) per Common Share:			
Basic:			
Income (loss) before cumulative effect of change in accounting principle	$ 0.16	$ (0.52)	**$ 0.17**
Cumulative effect of change in accounting principle	(0.15)	—	**—**
Net income (loss)	$ 0.01	$ (0.52)	**$ 0.17**
Diluted:			
Income (loss) before cumulative effect of change in accounting principle	$ 0.15	$ (0.52)	**$ 0.17**
Cumulative effect of change in accounting principle	(0.14)	—	**—**
Net income (loss)	$ 0.01	$ (0.52)	**$ 0.17**
Weighted Average Number of Common and Common Equivalent Shares:			
Basic	54,320	57,230	**58,480**
Diluted	56,885	57,230	**58,659**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity

in thousands

	Common stock Shares	Common stock Par value	Additional paid in capital	Accumulated deficit	Treasury stock	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance, December 31, 1999	53,280	$533	$171,270	$(26,409)	$(340)	$(4,518)	$140,536
Comprehensive income:							
Net income				765			765
Unrealized loss on marketable securities, net						(1,445)	(1,445)
Total comprehensive loss							(680)
Issuance of common stock	345	3	1,926				1,929
Cancellation of treasury stock	(83)	(1)	(339)		340		—
Tax benefit derived from exercise of stock options			1,353				1,353
Compensation expense in connection with options modification			1,592				1,592
Exercise of stock options	1,223	12	7,903				7,915
Balance, December 31, 2000	54,765	547	183,705	(25,644)	—	(5,963)	152,645
Comprehensive income:							
Net loss				(29,926)			(29,926)
Unrealized loss on marketable securities, net						(1,110)	(1,110)
Reclassification adjustment for realized loss included in net loss						7,193	7,193
Total comprehensive loss							(23,843)
Issuance of common stock in Myelos acquisition	2,345	23	19,009				19,032
Issuance of common stock	277	3	1,994				1,997
Tax benefit derived from exercise of stock options			925				925
Compensation expense in connection with options modification			1,024				1,024
Exercise of stock options	873	9	5,751				5,760
Balance, December 31, 2001	58,260	582	212,408	(55,570)	—	120	157,540
Comprehensive income:							
Net income				**9,717**			**9,717**
Unrealized loss on marketable securities, net						**(280)**	**(280)**
Currency translation adjustment						**277**	**277**
Total comprehensive income							**9,714**
Issuance of common stock	**469**	**5**	**1,792**				**1,797**
Exercise of stock options	**4**		**24**				**24**
Balance, December 31, 2002	**58,733**	**$587**	**$214,224**	**$(45,853)**	**$ —**	**$ 117**	**$169,075**

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

in thousands

Years ended December 31	2000	2001	**2002**
Cash Flows from Operating Activities:			
Net income (loss)	$ 765	$(29,926)	**$ 9,717**
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Cumulative effect of accounting change, net	8,178	—	**—**
Deferred income tax	140	(3,957)	**(837)**
Depreciation and amortization	2,861	2,937	**2,701**
Write-off of in-process research and development acquired	—	45,600	**—**
Compensation expense in connection with option modification	1,592	1,024	**—**
Amortization of negative goodwill and intangible assets associated with acquisitions	—	(2,961)	**1,013**
Unrealized loss on investments, net	—	8,963	**—**
Provision for inventory reduction	—	—	**976**
Provision for severance pay	260	636	**444**
Deferred revenues	3,834	(1,656)	**(1,553)**
(Gain) loss on disposal of property and equipment	(29)	10	**354**
Gain from forward contract	—	—	**(800)**
Realized loss on sales of short-term investments, net	446	1,735	**14**
Common stock as payment for services	60	70	**70**
Changes in:			
accounts receivable	(973)	14,572	**(8,265)**
inventories	(1,256)	(3,875)	**(1,202)**
prepaid expenses and other current assets	(769)	(405)	**(1,284)**
accounts payable	174	5,178	**7,541**
other current liabilities	(16)	(185)	**305**
Net cash provided by operating activities	15,267	37,760	**9,194**
Cash Flows from Investing Activities:			
Purchases of short-term investments	(48,738)	(10,407)	**(4,706)**
Capital expenditures	(10,913)	(23,974)	**(15,546)**
Severance pay funded	48	(64)	**(398)**
Other investments	—	(5,000)	**—**
Net proceeds from forward contract	—	—	**800**
Restricted cash	—	—	**(1,280)**
Other assets	126	69	**(86)**
Change in patents	(180)	—	**—**
Proceeds from sales of short-term investments	22,177	58,416	**43,919**
Net cash paid in acquisition	—	(15,603)	**(95,954)**
Proceeds from sales of property and equipment	79	214	**23**
Net cash (used in) provided by investing activities	(37,401)	3,651	**(73,228)**

continued on page 36

Consolidated Statements of Cash Flows *continued*

in thousands

Years ended December 31	2000	2001	**2002**
Cash Flows from Financing Activities:			
Proceeds from issuances of common stock	9,784	7,687	**1,751**
Proceeds from long-term loan	20,000	—	**—**
Repayment of long-term debt	—	—	**(1,234)**
Net cash provided by financing activities	29,784	7,687	**517**
Effect of exchange rate changes	—	—	**277**
Net increase (decrease) in cash and cash equivalents	7,650	49,098	**(63,240)**
Cash and cash equivalents at beginning of year	18,703	26,353	**75,451**
Cash and cash equivalents at end of year	$26,353	$75,451	**$12,211**
Supplementary Information:			
Other information:			
Interest paid	$ 269	$ 1,044	**$ 587**
Income taxes paid	$ 4,567	$ 3,937	**$ 6,777**
Tax benefit derived from exercise of stock options	$ 1,353	$ 925	**$ —**
Acquisitions:			
Assets acquired	$ —	$ 9,141	**$12,632**
Liabilities assumed	—	(1,125)	**(28,968)**
Goodwill	—	(18,914)	**40,080**
Intangible assets	—	—	**80,800**
Equity issued	—	(19,032)	**—**
In-process research and development acquired	—	45,600	**—**
Purchase price (including acquisition costs of $1,387 in 2001 and $5,421 in 2002)	—	15,670	**104,544**
Less—accrued acquisition costs	—	—	**(3,322)**
Less—cash acquired	—	(67)	**(5,268)**
Net cash paid	$ —	$15,603	**$95,954**
Non-Cash Activity:			
Capital expenditures unpaid as of December 31	$ —	$ 899	**$ 1,134**

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

Bio-Technology General Corp. ("BTG") and its wholly owned subsidiaries (collectively, the "Company") are engaged in the research, development, manufacture, and marketing of pharmaceutical products that address unmet medical needs in both niche and larger market segments. The Company distributes its products on a worldwide basis primarily through a direct sales force in the United States, the United Kingdom (for the Rosemont products), and Israel, and primarily through third-party license and distribution relationships elsewhere. Through a combination of internal research and development, acquisitions, collaborative relationships, and licensing arrangements, the Company has assembled a diverse portfolio of therapeutic products, many of which are currently being marketed, several of which are in registration or clinical trials, and several of which are in pre-clinical development.

BTG and its wholly owned subsidiary Bio-Technology General (Israel) Ltd. ("BTG-Israel") were formed in 1980 to research, develop, manufacture, and market products through the application of genetic engineering and related biotechnologies. On March 19, 2001, BTG acquired Myelos Corporation ("Myelos"), a privately held biopharmaceutical company focused on the development of novel therapeutics to treat diseases of the nervous system. On September 30, 2002, BTG, through its wholly owned subsidiary Acacia Biopharma Limited ("Acacia"), acquired Rosemont Pharmaceuticals Limited ("Rosemont"), a specialty pharmaceutical company located in the United Kingdom that develops, manufactures, and markets pharmaceutical products in oral liquid form.

a. Basis of consolidation The consolidated financial statements include the accounts of BTG, BTG-Israel, Myelos, Acacia, and Rosemont. Results of operations and cash flows of Myelos and Rosemont are included in the consolidated financial statements since March 19, 2001 and September 30, 2002, their respective dates of acquisition. All material intercompany transactions and balances have been eliminated.

b. Reclassifications Certain reclassifications have been made to 2000 and 2001 financial statements to conform to the 2002 presentation.

c. Translation of foreign currency The functional currency of BTG-Israel is the U.S. dollar. Accordingly, its transactions and balances are remeasured in dollars, and translation gains and losses (which are immaterial for all periods presented) are included in the statements of operations. The functional currency of Rosemont is the British pound sterling, and its translation gains and losses are included in accumulated other comprehensive income.

d. Cash and cash equivalents At December 31, 2001 and 2002, cash and cash equivalents included cash of $4,334,000 and $10,411,000, respectively, and money market funds, commercial paper, and other liquid short-term debt instruments (with maturities at date of purchase of ninety days or less) of $71,117,000 and $1,800,000, respectively. Cash and cash equivalents at December 31, 2001 and 2002 include $69,000 and $6,295,000, respectively, denominated in currencies other than the U.S. dollar.

e. Short-term investments (i) Short-term investments, which are carried at fair value, consist primarily of investments in mutual funds and corporate bonds that have been classified as "available-for-sale securities" pursuant to Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Unrealized holding gains and losses, which are deemed to be temporary, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. A decline in the market value of an available-for-sale security below cost that is deemed to be other than temporary is recognized as a charge in the consolidated statement of operations, and a new cost basis for the security is established.

At December 31, 2001 and 2002, management determined that the decline in the value of certain investments was other than temporary and, accordingly, cost was adjusted to reflect market value and a loss on impairment of investment of $7,193,000 and $1,168,000, respectively, was recognized and included in the statement of operations in other income (expense), net.

At December 31, 2001 and 2002, the cost of the securities available for sale was $40,642,000 and $7,147,000, respectively. Total realized and unrealized losses, net, included in other income (expense), net, for the years ended December 31, 2001 and 2002 were $9,231,000 and $1,181,000, respectively. There were no realized losses in 2000.

(ii) Cost basis investment included within other assets at December 31, 2001 and 2002 represents an equity investment of less than 20% in a private entity. Changes in the value of this investment are not recognized unless an impairment is deemed to be other than temporary. See Note 2.c.

f. Inventories Inventories are stated at the lower of cost or market. Cost is determined by using the weighted average method. At December 31, 2001 and 2002, inventories included raw materials of $1,706,000 and $2,214,000, work-in-process of $1,137,000 and $3,018,000, and finished goods of $11,297,000 and $11,380,000, respectively.

g. Property and equipment, net of accumulated depreciation and amortization Property and equipment are stated at cost. Depreciation has been calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to seventeen years. Leasehold improvements are amortized over the lives of the respective leases, which are shorter than the useful life. The cost of maintenance and repairs is expensed as incurred.

Land, building, and construction-in-progress represent a building under construction and are stated at cost. This includes cost of construction under the construction contracts, plant and equipment, capitalized interest, labor, and other direct costs. Interest is capitalized under the provision of SFAS No. 34, "Capitalization of Interest Cost." Capitalized interest was $339,000, $1,039,000, and $577,000 for the years ended December 31, 2000, 2001, and 2002, respectively, and totaled $1,378,000 and $1,955,000 at December 31, 2001 and 2002, respectively. Construction-in-progress is not depreciated until such time as the relevant assets are completed and ready for their intended use.

h. Intangible assets At December 31, 2002, intangible assets consist mainly of developed products, trademarks, and several patents acquired in the Rosemont acquisition and are being amortized, using the straight-line method, over the estimated useful life of approximately twenty years. The estimation of the useful life of the intangible assets was determined by BTG's management based on a preliminary independent appraisal and information currently available. At December 31, 2001, intangibles consist of repurchased rights to one of the Company's products previously licensed to a third party, and are being amortized, using the straight-line method over the shorter of the life of the related revenue stream or seven years, commencing with the initial sale of the related product.

i. Long-lived assets The Company's long-lived assets include property and equipment, intangible assets, and goodwill.

As of January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," which eliminated the amortization of purchased goodwill. As a result, the Company is no longer amortizing the negative goodwill resulting from the Myelos acquisition. Under SFAS No. 142, the negative goodwill balance of $16,028,000 remaining at December 31, 2002 will be maintained on the balance sheet as a deferred credit until it is either netted against the contingent payments, if any, made to the former Myelos shareholders or reflected in net income as an extraordinary item, should the contingent payments not become due. Under SFAS No. 142, goodwill is tested annually and more frequently if an event occurs that indicates the goodwill may be impaired. SFAS No. 142 requires companies to use a fair value approach to determine whether there is an impairment event.

The following table presents a reconciliation of net income and earnings per share amounts, as reported in the financial statements, to those amounts adjusted for negative goodwill amortization, determined in accordance with SFAS No. 142.

in thousands, except per share data Years ended December 31	2000	2001	**2002**
Reported net income (loss)	$ 765	$(29,926)	**$ 9,717**
Deduct: negative goodwill amortization	—	(2,961)	**—**
Adjusted net income (loss)	$ 765	$(32,887)	**$ 9,717**
Basic earnings (loss) per common share:			
As reported	$ 0.01	$ (0.52)	**$ 0.17**
Negative goodwill amortization	—	(0.05)	**—**
Adjusted	$ 0.01	$ (0.57)	**$ 0.17**
Diluted earnings (loss) per common share:			
As reported	$ 0.01	$ (0.52)	**$ 0.17**
Negative goodwill amortization	—	(0.05)	**—**
Adjusted	$ 0.01	$ (0.57)	**$ 0.17**

As of January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to Be Disposed Of." Under SFAS No. 144, intangible assets other than goodwill are reviewed on a periodic basis for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. Such events or changes in circumstances include, but are not limited to: (a) a significant decrease in the market price of a long-lived asset (or asset group); (b) a significant adverse change in the extent or manner in which a long-lived asset (or asset group) is being used or in its physical condition; (c) a significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (or asset group), including an adverse action or assessment by a regulator; (d) an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (or asset group); (e) a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (or asset group); and (f) a current expectation that, more likely than not, a long-lived asset (or asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The Company's management believes that no such event or change has occurred. The adoption of SFAS No. 144 had no effect on the Company.

j. Revenue recognition Product sales are recognized when the product is shipped and collectability is probable, net of discounts, sales incentives, sales allowances, and freight out.

Contract fees consist mainly of license of marketing and distribution rights and research and development projects. Effective January 1, 2000, the Company adopted Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," issued by the Securities and Exchange Commission in December 1999. As a result, the Company changed the way it recognizes revenue for up-front non-refundable contract fees for the license of marketing and distribution rights. Prior to the issuance of SAB No. 101, the Company recorded revenues from the license of marketing and distribution rights when the rights were licensed and/or when these payments were received. In accordance with SAB No. 101, contract fee revenues are now being recognized over the estimated term of the related agreements, which range from five to sixteen years. Effective January 1, 2000, the Company recorded a cumulative effect of a change in the accounting principle related to contract revenues recognized in prior years in the amount of $12,558,000, net of income taxes of $4,380,000, of which $853,000, $1,156,000, and $1,146,000 were recognized as contract fee revenues in 2000, 2001, and 2002, respectively.

Revenues related to performance milestones are recognized based upon the achievement of the milestone, as defined in the respective agreements, and when collectability is probable. Advance payments received in excess of amounts earned are included in deferred revenues.

Royalties are recognized once agreement exists, the sale is made, and the royalty is earned.

Other revenues represent funds received by the Company for research and development projects that are partially funded by collaborative partners and the Chief Scientist of the State of Israel ("Chief Scientist"), respectively. The Company recognizes revenues upon performance of such funded research. In general, these contracts are cancelable by the Company's collaborative partners at any time.

k. Stock-based compensation At December 31, 2002, the Company has stock-based compensation plans, which are described more fully in Notes 10 and 11. As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company accounts for stock-based compensation arrangements with employees in accordance with provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Compensation expense for stock options issued to employees is based on the difference on the date of grant, between the fair value of the Company's stock and the exercise price of the option. No stock-based employee compensation cost is reflected in net income upon option grant, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock at the date of grant. The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation:

in thousands, except per share data Years ended December 31	2000	2001	**2002**
Net income (loss):			
As reported	$ 765	$(29,926)	**$ 9,717**
Deduct:			
Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	10,509	13,731	**13,853**
Pro forma	$(9,744)	$(43,657)	**$(4,136)**
Basic earnings (loss) per common share:			
As reported	$ 0.01	$ (0.52)	**$ 0.17**
Pro forma	$ (0.18)	$ (0.76)	**$ (0.07)**
Diluted earnings (loss) per common share:			
As reported	$ 0.01	$ (0.52)	**$ 0.17**
Pro forma	$ (0.18)	$ (0.76)	**$ (0.07)**

l. Research and development All research and development costs are expensed as incurred.

m. Income taxes Deferred income taxes are recognized for the tax consequences of temporary differences by applying the enacted statutory tax rates to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and for capital and net operating losses and tax credits carryforward. When it is not considered more likely than not that a part or the entire deferred tax asset will be realized, a valuation allowance is recognized.

BTG-Israel and Rosemont file separate income tax returns and provide for taxes under local laws.

n. Other comprehensive income (loss) Other comprehensive income (loss) consists of unrealized gains (losses) on marketable securities and currency translation gains (losses) from the translation of Rosemont's financial statements from British pounds sterling to U.S. dollars.

o. Earnings per common share Net earnings per common share amounts ("basic EPS") are computed by dividing net earnings by the weighted average number of common shares outstanding and exclude any potential dilution. Net earnings per common share amounts assuming dilution ("diluted EPS") are computed by reflecting potential dilution from the exercise of stock options.

A reconciliation between the numerators and denominators of the basic and diluted EPS computations for net earnings is as follows:

in thousands, except per share data	Income (numerator)	Shares (denominator)	Per share amounts
Year Ended December 31, 2000			
Net earnings	$ 765		
Basic EPS:			
Net earnings attributable to common stock	765	54,320	$ 0.01
Effect of dilutive securities:			
Stock options		2,565	
Diluted EPS:			
Net earnings attributable to common stock and assumed option exercises	$ 765	56,885	$ 0.01
Year Ended December 31, 2001			
Net loss	$(29,926)		
Basic EPS:			
Net loss attributable to common stock	(29,926)	57,230	$ (0.52)
Effect of dilutive securities:			
Stock options		—	
Diluted EPS:			
Net loss attributable to common stock and assumed option exercises	$(29,926)	57,230	$ (0.52)
Year Ended December 31, 2002			
Net earnings	**$ 9,717**		
Basic EPS:			
Net earnings attributable to common stock	**9,717**	**58,480**	**$ 0.17**
Effect of dilutive securities:			
Stock options		**179**	
Diluted EPS:			
Net earnings attributable to common stock and assumed option exercises	**$ 9,717**	**58,659**	**$ 0.17**

Options to purchase 732,000 and 6,989,000 shares of common stock out of the total number of options outstanding as of December 31, 2000 and 2002, respectively, are not included in the computation of diluted EPS because of their anti-dilutive effect. In 2001, all options outstanding as of December 31, 2001 are excluded from the computation of diluted EPS because of their anti-dilutive effect.

p. Use of estimates in preparation of financial statements The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to investments, accounts receivable, inventories, property and equipment, intangible assets, and income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions.

q. Fair value of financial instruments The carrying amounts of accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. The carrying amount of the long-term debt approximates fair value as the borrowing rates are variable and are currently available for debt with similar terms and maturities.

r. Concentration of credit risk Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments, and accounts receivable. The Company places its cash and cash equivalents and short-term investments with high-quality financial institutions and limits the amount of credit exposure to any one institution. Concentration of credit risk with respect to accounts receivable is discussed in Note 13. Generally, the Company does not require collateral from its customers; however, collateral or other security for accounts receivable may be obtained in certain circumstances when considered necessary.

s. New accounting pronouncements In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement is effective for fiscal years beginning after June 15, 2002. The Company is currently assessing the impact of this new standard, although it does not expect it to affect its results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. SFAS No. 146 will be applied to exit or disposal activities after December 31, 2002 and is not expected to have a material effect on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure: an amendment of FASB Statement No. 123," to provide alternative transition methods for a voluntary change to the fair-value-based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in annual financial statements about the method of accounting for stock-based employee compensation and the pro forma effect on reported results of applying the fair-value-based method for entities that use the intrinsic value method of accounting. The pro forma effect disclosures are also required to be prominently disclosed in interim period financial statements. This statement is effective for financial statements for fiscal years ending after December 15, 2002 and is effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002, with earlier application permitted. BTG does not plan a change to the fair-value-based method of accounting for stock-based employee compensation and has included the disclosure requirements of SFAS No. 148 in the accompanying financial statements.

In November 2002, FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN No. 45"), was issued. FIN No. 45 requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee. BTG previously did not record a liability when guaranteeing obligations unless it became probable that BTG would have to perform under the guarantee. FIN No. 45 applies prospectively to guarantees BTG issues or modifies subsequent to December 31, 2002, but has certain disclosure requirements effective for interim and annual periods ending after December 15, 2002. BTG has not yet determined the effects of FIN No. 45 on its financial statements. Disclosures required by FIN No. 45 are included in the accompanying financial statements.

2. Acquisitions and Investments

a. Acquisition of Rosemont Pharmaceuticals Limited On September 30, 2002, BTG, through its wholly owned subsidiary Acacia, completed the acquisition of all of the stock of Rosemont, a subsidiary of Akzo Nobel N.V. Rosemont is a leader in the U.K. market for oral liquid formulations of branded non-proprietary drugs. The purchase price (including acquisition costs of approximately $5,421,000) for Rosemont, which was funded from BTG's cash on hand, was approximately $104,544,000, excluding Rosemont's cash balances.

The acquisition has been accounted for under the purchase method of accounting. The aggregate purchase price of $104,544,000 is being allocated based on the estimates of the fair value of the tangible and intangible assets acquired and liabilities assumed as follows:

in thousands

Assets acquired:	
Current assets (including cash acquired of $5,268)	$ 10,924
Fixed assets	1,708
Intangibles	80,800
Goodwill	40,080
Liabilities assumed:	
Current liabilities	(4,728)
Deferred tax liabilities	(24,240)
Total purchase price	$104,544

The estimation of the fair value of assets acquired and liabilities assumed was determined by BTG's management based on a preliminary independent appraisal and information currently available. BTG is in the process of completing the evaluation of certain acquired assets, as well as certain intangibles. Accordingly, the allocation of the purchase price is subject to revisions. Intangible assets consist primarily of developed products and will be amortized, using the straight-line method, over the estimated useful life of approximately twenty years. The estimation of the useful life of the intangible assets was determined by BTG's management based on a preliminary independent appraisal and information currently available. BTG is in the process of completing the useful life assessment and, accordingly, it is subject to revision.

Intangible assets consist of developed products, trademarks, and one patent, and are being amortized, using the straight-line method, over the estimated useful life of approximately twenty years. The estimation of the useful life of the intangible assets was determined by BTG's management based on an independent appraisal and information currently available.

The accompanying consolidated financial statements include the assets and liabilities of Rosemont as of December 31, 2002 and its results of operations for the three months ended December 31, 2002 but exclude the results of Rosemont for all other periods presented. The following unaudited pro forma consolidated results of operations for the years ended December 31, 2001 and 2002 were prepared assuming the acquisition of Rosemont occurred on January 1, 2001. The pro forma results of operations are not necessarily indicative of the consolidated results that actually would have occurred if the acquisition had been consummated at January 1, 2001, nor do they purport to represent the results of operations for future periods.

unaudited
in thousands, except per share data

Years ended December 31	2001		2002	
	As reported	Pro forma	As reported	Pro forma
Total revenues	$ 94,774	$113,272	**$102,966**	**$119,094**
Net income (loss)	(29,926)	(27,442)	**9,717**	**13,059**
Earnings (loss) per common share:				
Basic	$ (0.52)	$ (0.48)	**$ 0.17**	**$ 0.22**
Diluted	$ (0.52)	$ (0.48)	**$ 0.17**	**$ 0.22**

In connection with the acquisition, BTG entered into a forward contract for the delivery of the £64,000,000 purchase price on September 30, 2002 at a cost of $99,123,200 (representing an exchange rate of $1.5488 per £1). The exchange rate at the acquisition closing date was $1.5614 per £1. In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which prohibits hedge accounting for a hedge of an anticipated business combination, BTG recorded a gain of approximately $800,000 on the forward contract, which gain is included in other income (expense), net.

b. Acquisition of Myelos Corporation On March 19, 2001, the Company acquired Myelos, a privately held biopharmaceutical company focused on the development of novel therapeutics to treat diseases of the nervous system. Under the terms of the acquisition agreement, the Company paid Myelos shareholders $35,000,000 in a combination of cash and stock ($14,000,000 in cash and $21,000,000 through the issuance of approximately 2,344,700 shares of the Company's common stock, based on a per share value of $8.9564, representing the average closing price of the Company's common stock for the twenty-trading-day period ending one day prior to February 21, 2001, the date the acquisition agreement was executed). In addition, the Company has agreed to pay the Myelos shareholders an additional $30,000,000 if the Company is able to file a New Drug Application with respect to Prosaptide to treat neuropathic pain or neuropathy, of which at least $14,000,000 will be paid through the issuance of shares of Company common stock. The remaining $16,000,000 can be paid, at the Company's option, in cash, shares of Company common stock, or a combination thereof. The Company has also agreed that if Prosaptide is approved by the U.S. Food and Drug Administration ("FDA") for the treatment of neuropathic pain or neuropathy, the Company will pay the Myelos shareholders 15% of net sales of Prosaptide during the twelve-month period beginning on the earlier of (i) the twenty-fifth full month after commercial introduction of Prosaptide in the United States for the treatment of neuropathic pain or neuropathy, or (ii) April 1, 2010. At least 50% of this payment must be in shares of Company common stock, with the remainder payable, at the Company's option, in cash, shares of Company common stock, or a combination thereof. In no event is the Company required to issue more than 10,962,000 shares of its common stock; any equity required to be issued in excess of that amount will be issued in shares of Company preferred stock. The preferred stock would be non-voting, non-convertible, non-transferable, non-dividend paying (except to the extent a cash dividend is paid on the Company common stock), with no mandatory redemption for a period of twenty years and one day from the closing date of the acquisition, and a right to share in proceeds in liquidation, up to the liquidation amount.

The transaction was treated as a "purchase" for accounting purposes. The purchase price for accounting purposes was approximately $34,387,000 (including acquisition costs of $1,387,000), based on a per share value for the approximately 2,344,700 shares of Company common stock issued in the acquisition of $8.1172, representing the average closing price of the Company's common stock for the four-day period preceding February 21, 2001, the date the terms of the acquisition were agreed to. In connection with the merger and based on an independent valuation, the Company allocated $45,600,000 to in-process research and development projects of Myelos, representing the estimated fair value based on risk-adjusted cash flows of the acquired technology. At the date of the merger, the technology acquired in the acquisition was not fully commercially developed and had no alternative future uses. Accordingly, the value was expensed as of the acquisition date. The Company recorded negative goodwill of $18,989,000 on its balance sheet, primarily because the amount written off as in-process research and development acquired exceeded the purchase price for accounting purposes. During 2001, this negative goodwill was being amortized over its expected useful life of five years. In accordance with SFAS No. 142, amortization of the negative goodwill ceased beginning January 1, 2002, and the balance remaining will be maintained as a deferred credit until it is either netted against the contingent payments or reflected in net income as an extraordinary item, should the contingent payments not become due because the technology did not meet the milestones that trigger payment.

The Company allocated values to the in-process research and development based on an independent valuation of the research and development project. The value assigned to these assets was determined by estimating the costs to develop the acquired technology into a commercially viable product, estimating the resulting net cash flows from the product, and discounting the net cash flows to their present value. The revenue projection used to value the in-process research and development was based on estimates of relevant market size and growth factors, expected trends in technology, and the nature and expected timing of new product introductions by the Company and its competitors. The resulting net cash flows from such product are based on management's estimates of cost of sales, operating expenses, and income taxes from such product. The Company believes that the assumptions used in the forecasts were reasonable at the time of the merger. No assurance can be given, however, that the underlying assumptions used to estimate sales, development costs or profitability, or the events associated with such product, will transpire as estimated. For these reasons, actual results may vary from projected results. The most significant and uncertain assumptions relating to the in-process research and development relate to the ability to successfully develop a product and the projected timing of completion of, and revenues attributable to, that product.

c. Investment in Omrix Biopharmaceuticals, Inc. In January 2001, in order to obtain a period of exclusivity to negotiate a possible strategic relationship with Omrix Biopharmaceuticals, Inc. ("Omrix"), the Company loaned $2,500,000 to Omrix and agreed to convert the loan into and purchase an additional $2,500,000 of shares of Omrix preferred stock if it did not pursue a relationship. The Company determined not to pursue a strategic relationship with Omrix and, on March 31, 2001, converted the existing loan into and purchased an additional $2,500,000 of shares of Omrix preferred stock, which are convertible into approximately 4.5% of Omrix common stock (on a fully diluted basis). This investment is carried at cost and is included as a component of other long-term assets. Omrix is a privately held company that develops and markets a unique surgical sealant and a number of immunology products based on blood plasma processing technology. Omrix currently sells its products in Europe, South America, and the Middle East.

During the fourth quarter of 2001, the Company determined that the decline in the value of its investment in Omrix was other than temporary and, accordingly, wrote down the value of this investment by $3,000,000 based on management's evaluation of current market conditions and Omrix's operations and forecasts. The write-down is included in the year ended December 31, 2001 as a component of other income (expense), net. Based on the current information available regarding Omrix, management believes the current carrying value of its investment in Omrix is appropriate.

3. Property and Equipment, Net

in thousands

December 31	2001	**2002**
Laboratory and manufacturing equipment[1]	$ 28,098	**$ 37,482**
Office equipment[2]	4,842	**7,108**
Air-conditioning and other	4,613	**4,734**
Leasehold improvements	8,054	**10,026**
	45,607	**59,350**
Land, building, and construction in progress[3]	29,265	**39,152**
	74,872	**98,502**
Accumulated depreciation and amortization	(23,813)	**(31,906)**
Total	$ 51,059	**$ 66,596**

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1. Includes $8,784,000 and $10,984,000 of equipment not placed in use at December 31, 2001 and 2002, respectively, and therefore no depreciation and amortization has been accumulated.
2. Includes $2,327,000 and $2,599,000 of equipment not placed in use at December 31, 2001 and 2002, respectively, and therefore no depreciation and amortization has been accumulated.
3. The related asset, which is a production facility in Israel intended to meet FDA current Good Manufacturing Practice requirements, is not ready for its intended use and therefore no depreciation and amortization has been accumulated as of December 31, 2002. Includes $2,815,000 and $9,837,000 of capitalized interest, labor, and other costs as of December 31, 2001 and 2002, respectively, which in 2002 includes increased validation costs. This balance includes $6,500,000 of land and building costs (including local taxes and legal fees) associated with this facility.

The manufacture of each product at the new Israeli manufacturing facility must be approved by applicable regulatory authorities, including the FDA for products shipped to the United States, prior to the resumption of manufacturing of that product at the new facility. As a result of the violence in Israel in recent years, the FDA has from time to time suspended its inspections in Israel.

Depreciation expense was approximately $1,982,000, $2,295,000, and $2,474,000 for the years ended December 31, 2000, 2001, and 2002, respectively.

4. Acquired Intangible Assets

The following summarizes the carrying amounts of acquired intangible assets and related amortization:

in thousands As of December 31, 2002	Gross carrying amount	Accumulated amortization
Amortized intangible assets:		
Developed products	$76,700	$ 959
Trademarks	3,300	41
Patents	891	13
Total	$80,891	$1,013
Unamortized intangible assets:		
Goodwill	$40,080	
Amortization expense:		
For year ended December 31, 2002	$ 1,013	
Estimated amortization expense:		
For year ending December 31, 2003	$ 4,050	
For year ending December 31, 2004	$ 4,050	
For year ending December 31, 2005	$ 4,050	
For year ending December 31, 2006	$ 4,050	
For year ending December 31, 2007	$ 4,050	

5. Other Current Liabilities

in thousands December 31	2001	**2002**
Salaries and related expenses	$ 3,836	**$ 5,639**
Accrued subcontracting payable	3,516	**5,235**
Governmental and state agencies	875	**4,133**
Legal and professional fees	978	**720**
Royalties and commissions	1,512	**932**
Other	451	**361**
	$11,168	**$17,020**

6. Severance Pay

BTG-Israel participates in a defined contribution pension plan and makes regular deposits with a pension fund to secure pension rights on behalf of some of its employees. The custody and management of the amounts so deposited are independent of the Company and, accordingly, such amounts funded (included in expenses on an accrual basis) and related liabilities are not reflected in the balance sheets. The Company's obligation for severance pay, in addition to the amount funded, is included within long-term liabilities in the accompanying consolidated balance sheets.

In respect of its other employees, BTG-Israel purchases individual insurance policies intended to cover its severance obligations. The amount funded in the insurance policy and its obligation for severance pay to those employees are reflected in the consolidated balance sheets as severance pay funded and severance pay, respectively.

The liability of the Company for severance pay is calculated on the basis of the latest salary paid to its employees and the length of time they have worked for the Company. The liability is covered by the amounts deposited, including accumulated income thereon, as well as by the unfunded liability.

The expense related to severance and pension pay for the years ended December 31, 2000, 2001, and 2002 was $1,434,000, $1,648,000, and $1,297,000, respectively.

7. Long-Term Debt

In June 2000, the Company entered into a $20,000,000 credit facility with Bank Hapoalim B.M. to finance a portion of the cost of completing its new production facility. Loans under the credit facility, which is secured by the assets of BTG-Israel and has been guaranteed by the Company, bear interest at the rate of libor plus 1%. At December 31, 2001 and 2002, the Company had long-term borrowings of $20,000,000 and $18,889,000, respectively, outstanding under the credit facility, of which $1,111,000 and $6,667,000, respectively, are included in current portion of long-term debt. At December 31, 2002, the loans are at an average interest rate of approximately 2.5%, and the principal is payable as follows: in 2003 — $6,667,000; in 2004 — $6,667,000; and in 2005 — $5,555,000.

8. Commitments and Contingent Liabilities

a. BTG's administrative offices are located in East Brunswick, New Jersey, where it has leased approximately 53,000 square feet of office space. The lease has a base average annual rental expense of approximately $1,728,000 and expires in March 2013. There are two five-year renewal options. In connection with this lease arrangement, the Company was required to provide a security deposit by way of an irrevocable letter of credit for $1,280,000, which amount is reflected in other assets on the balance sheet at December 31, 2002. In addition, BTG leases approximately 2,000 square feet in New York City for its business activities, including its investor and public relations activities. This lease expires in September 2003. BTG also leases approximately 10,000 square feet of space in San Diego, California, where our Prosaptide research is being conducted. This lease expires in October 2004.

BTG has a research, development, and manufacturing facility located in Rehovot, Israel, where BTG-Israel leases approximately 95,000 square feet at an annual rental of approximately $995,000. This lease expires in December 2005.

Rosemont's development and manufacturing facility is located in Leeds, United Kingdom, where it leases approximately 41,000 square feet at an annual rental of approximately $270,000. The lease for 6,000 square feet expires in December 2003, the lease for 4,000 square feet expires in April 2004, and the remainder of 31,000 square feet expires in December 2004.

Rent expense was approximately $1,787,000, $1,830,000, and $2,223,000 for the years ended December 31, 2000, 2001, and 2002, respectively.

The future annual minimum rentals (exclusive of amounts for real estate taxes, maintenance, etc.) for each of the following years are: 2003 — $3,176,000; 2004 — $3,026,000; 2005 — $2,723,000; 2006 — $1,728,000; 2007—$1,728,000; and 2008 to 2013—$9,069,000. There is also a bank guarantee outstanding in favor of the lessor of the Israeli facility for $458,000 secured by the assets of BTG-Israel.

b. The Company is obligated, for products resulting from research and development projects partially funded by the Chief Scientist, to pay royalties to the Israeli government of 3% to 5% on commercial sales, if any, of these products if produced in Israel up to the amount so funded, or royalties of 4% to 6% if produced outside Israel up to 120% to 300% of the amount so funded. As of December 31, 2002, the Company is obligated to repay to the Chief Scientist, out of revenues from future product sales, a minimum of $5,241,000 of research and development funding for products that are currently being sold and a minimum of $7,644,000 of research and development funding for products currently under development if these products will be sold. During the years ended December 31, 2000, 2001, and 2002, the Company recognized approximately $529,000, $304,000, and $258,000, respectively, as royalties to the Chief Scientist.

The Company is also committed to pay royalties on future sales, if any, of certain of its products to licensees from which the Company licensed these products.

c. At December 31, 2002, the Company had employment agreements with seven senior officers. Under these agreements, the Company has committed to total aggregate base compensation per year of approximately $2,117,000 plus other normal customary fringe benefits and bonuses. These employment agreements generally have a term of three years and are automatically renewed for successive one-year periods unless either party gives the other notice of non-renewal.

d. The Company has received notification of claims filed that certain of its products may infringe certain third-party patents in the normal course of operations. Management believes that these claims have no merit, and the Company intends to defend them vigorously and does not expect significant adverse impact on its financial position, results of operations, or cash flows as a result of the outcome. However, were an unfavorable ruling to occur in any subsequent period, there exists the possibility of a material adverse impact on the operating results. No accrual can be determined at this time.

e. On December 20, 2002, a purported shareholder class action was filed against the Company and three of its officers. The action is pending under the caption *A.F.I.K. Holding SPRL v. Fass*, No. 02-6048 (HAA) in the U.S. District Court for the District of New Jersey and alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Plaintiff purports to represent a class of shareholders who purchased shares of the Company between April 19, 1999 and August 2, 2002. The complaint asserts that the Company's financial statements were materially false and misleading because the Company restated its earnings and financial statements for the years ended 1999, 2000, and 2001, as reflected in the Company's Form 8-K and accompanying press release issued August 2, 2002. Five virtually identical actions were filed in January and February 2003. Plaintiffs have moved to consolidate the actions and to appoint a lead plaintiff and lead counsel in accordance with the Private Securities Litigation Reform Act.

On January 23, 2003, a purported shareholder derivative action was filed on behalf of the Company against nine of the Company's officers and directors, the Company's former auditor, Arthur Andersen, and the Company as a nominal defendant. The allegations in the derivative action are substantially similar to the allegations in the purported shareholder class actions. The derivative action is pending under the caption *Nelson v. Conrad*, No. 7-794-03, in the Superior Court of New Jersey, Middlesex County. A second purported shareholder derivative action, *Millet v. Conrad*, No. L-1275-03, was filed on February 14, 2003 and is pending in the same court.

The Company intends to vigorously defend against all allegations of wrongdoing. The Company has referred these claims to its directors and officers insurance carrier, which has reserved its rights as to coverage with respect to these actions.

f. The Company is obligated under certain circumstances to indemnify certain customers for certain or all expenses incurred and damages suffered by them as a result of any infringement of third-party patents. In addition the Company is obligated to indemnify its officers and directors against all reasonable costs and expenses related to stockholder and other claims pertaining to actions taken in their capacity as officers and directors that are not covered by the Company's directors and officers' insurance policy. These indemnification obligations are in the regular course of business and, in most cases, do not include a limit on a maximum potential future payment, nor are there any recourse provisions or collateral that may offset the cost. As of December 31, 2002, the Company has not recorded a liability for any obligations arising as a result of these indemnification obligations.

9. Stockholders' Equity

In 1998, the Company adopted a stockholder rights plan intended to deter hostile or coercive attempts to acquire the Company. Under the plan, if any person or group acquires more than 20% of the Company's common stock without approval of the Board of Directors under specified circumstances, the Company's other stockholders have the right to purchase shares of the Company's common stock, or shares of the acquiring company, at a substantial discount to the public market price. The stockholder rights plan is intended to ensure fair value to all stockholders in the event of an unsolicited takeover offer.

As discussed in Note 2.b., BTG may be obligated to issue additional shares of common stock to the former shareholders of Myelos.

10. Stock Options

In the years ended December 31, 2000, 2001, and 2002, the Company issued 1,223,000 shares, 873,000, shares and 4,000 shares, respectively, of the Company's common stock upon the exercise of outstanding stock options and received proceeds of $7,915,000, $5,760,000, and $24,000 respectively.

In 1992, the Company adopted the Bio-Technology General Corp. 1992 Stock Option Plan (the "1992 Stock Option Plan"). The 1992 Stock Option Plan permits the granting of options to purchase up to an aggregate of 12,000,000 shares of the Company's common stock to key employees (including employees who are directors) and consultants of the Company. Under the 1992 Stock Option Plan, the Company may grant either incentive stock options, at an exercise price of not less than 100% of the fair market value of the underlying shares on the date of grant, or non-qualified stock options, at an exercise price not less than the par value of the common stock on the date of grant. Options generally become exercisable ratably over two- or four-year periods, with unexercised options expiring after the earlier of ten years or shortly after termination of employment. No further options can be issued under the 1992 Plan.

In 2001, the Company adopted the 2001 Stock Option Plan (the "2001 Stock Option Plan"). The 2001 Stock Option Plan permits the granting of options to purchase up to an aggregate of 10,000,000 shares of the Company's common stock to employees (including employees who are directors) and consultants of the Company. Under the 2001 Stock Option Plan, the Company may grant either incentive stock options, at an exercise price of not less than 100% of the fair market value of the underlying shares on the date of grant, or non-qualified stock options, at an exercise price not less than 85% of the fair market value of the underlying shares on the date of grant. Options generally become exercisable ratably over two- or four-year periods, with unexercised options expiring after the earlier of ten years or shortly after termination of employment. Terminated options are available for reissuance. Under this plan, 7,805,000 shares remain available for future grant at December 31, 2002.

The Company also established a Stock Option Plan for New Directors (the "New Director Plan") that, upon an individual's initial election or appointment to the Board of Directors, provides for the grant of an option to purchase 20,000 shares of common stock at an exercise price equal to the market value of the common stock on the date of grant. Options become exercisable over a three-year period. The New Director Plan expired January 29, 2000, although previously granted options remain outstanding.

In June 1997, the Company adopted the Bio-Technology General Corp. 1997 Stock Option Plan for Non-Employee Directors (the "Directors Plan"). The Directors Plan provides that each non-employee director will automatically receive an option to purchase 7,500 shares of the Company's common stock on each date such person is reelected a director of the Company. The exercise price of each option is equal to the market value of the common stock on the date of grant. Options become exercisable over a three-year period. An aggregate of 500,000 shares of common stock has been reserved for issuance under the Directors Plan. The Board of Directors terminated the Directors Plan in February 2002, and instead provided that each non-employee director would receive, under the 2001 Stock Option Plan, an option to purchase 5,000 shares of the Company's common stock on the last business day of each quarter, commencing with the quarter ended March 31, 2002. The exercise price of each option is equal to the market value of the common stock on the date of grant, and options become fully exercisable on the first anniversary of the date of grant.

Transactions under the 1992 Stock Option Plan, the 2001 Stock Option Plan, the New Director Plan, and the Directors Plan during 2000, 2001, and 2002 were as follows:

Years ended December 31	2000		2001		**2002**	
	Shares in thousands	Weighted average exercise price	Shares in thousands	Weighted average exercise price	Shares in thousands	Weighted average exercise price
Options outstanding at beginning of year	7,487	$ 7.38	7,037	$ 8.39	**7,917**	**$ 9.47**
Granted	1,506	11.85	2,095	11.89	**1,730**	**4.93**
Exercised	(1,223)	6.47	(873)	6.59	**(4)**	**5.94**
Terminated	(733)	8.39	(342)	9.42	**(1,070)**	**9.59**
Options outstanding at end of year	7,037	8.39	7,917	9.47	**8,573**	**8.54**
Exercisable at end of year	2,706		4,319		**4,941**	
Weighted average fair value of options granted		$ 7.62		$ 7.65		**$ 3.21**

Under SFAS No. 123, the fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2000, 2001, and 2002: (i) expected life of option of seven years; (ii) dividend yield of 0%; (iii) expected volatility of 59%, 62%, and 64%; and (iv) risk-free interest rate of 5.62%, 3.50%, and 3.50%, respectively.

Of the 8,573,000 options outstanding as of December 31, 2002:

- 2,762,000 have exercise prices between $2.10 and $6.89 with a weighted average exercise price of $4.91 and a weighted average remaining contractual life of 7.01 years. Of these 2,762,000 options, 1,399,000 are exercisable; their weighted average exercise price is $5.29.
- 2,811,000 options have exercise prices between $7.00 and $9.87 with a weighted average exercise price of $7.83 and a weighted average remaining contractual life of 5.52 years. Of these 2,811,000 options, 2,372,000 are exercisable; their weighted average exercise price is $7.87.
- 3,000,000 options have exercise prices between $10.25 and $20.44 with a weighted average exercise price of $12.54 and a weighted average remaining contractual life of 7.60 years. Of these 3,000,000 options, 1,170,000 are exercisable; their weighted average exercise price is $12.64.

During 2000 and 2001, the Company made modifications to the period of vesting and exercisability of approximately 446,000 stock option awards and 273,000 stock option awards, respectively, for certain employees in connection with the termination of their employment and post-employment consulting arrangements. As a result, the Company recognized stock compensation expense of $1,592,000 and $1,024,000 during 2000 and 2001, respectively, which was primarily included in research and development expenses.

11. Employee Benefits

a. Employee stock purchase plan In April 1998, the Company adopted the 1998 Employee Stock Purchase Plan (the "1998 ESPP"). The 1998 ESPP is qualified as an employee stock purchase plan under Section 423 of the Internal Revenue Code of 1986, as amended. Under this plan, 3,000,000 shares have been reserved for issuance. All full-time employees of the Company in the United States and Israel are eligible to participate in the 1998 ESPP. From time to time, the Board of Directors may fix a date or a series of dates on which the Company will grant rights to purchase shares of common stock under the 1998 ESPP ("Rights") at prices not less than 85% of the lesser of (i) the fair market value of the shares on the date of grant of such Rights, or (ii) the fair market value of the shares on the date such Rights are exercised. Rights granted under the 1998 ESPP will run for a maximum of twenty-seven months. No employee may be granted a Right that permits such employee to purchase shares under the 1998 ESPP having a fair market value that exceeds $25,000 (determined at the time such Right is granted) for each calendar year in which such Right is outstanding, and no Right granted to any participating employee may cover more than 12,000 shares. In 2000, 2001, and 2002, the Company issued 339,000 shares, 268,000 shares, and 451,000 shares, respectively, of common stock under the 1998 ESPP.

b. 401(k) profit-sharing plan BTG has a 401(k) profit-sharing plan. As of December 31, 2002, the 401(k) plan permits employees who meet the age and service requirements to contribute up to $11,000 of their total compensation on a pre-tax basis, which is matched 50% by BTG. BTG's contribution to the plan amounted to approximately $348,000, $391,000, and $444,000 for the years ended December 31, 2000, 2001, and 2002, respectively.

c. Pension plan Rosemont operates a defined contribution pension plan for the benefit of its employees. The assets of the plan are administered by trustees in a fund independent from those of the Company. Under the pension plan, an employee contributes 3.5% of his or her pensionable annual salary (annual base salary minus the income tax exempt portion), and Rosemont makes a matching contribution equal to 8% of the pensionable annual salary. If the working relationship terminates within two years from the date the employee joined the pension plan, he or she is then entitled to a refund of his or her contribution only. If the working relationship terminates after two years, the entire amount accumulated in the pension plan is considered a deferred benefit. The pension cost charge for the three months ended December 31, 2002 was $1,286,000, which includes a one-time contribution of $1,100,000 to the pension plan made in connection with the acquisition of Rosemont.

12. Other Income (Expense), Net

in thousands

Years ended December 31	2000	2001	**2002**
Gain on forward contract	$ —	$ —	**$ 800**
Investment income	7,496	7,472	**2,654**
	7,496	7,472	**3,454**
Less:			
Realized and unrealized losses on investments, net	—	12,231	**1,181**
Interest and other expense	120	170	**631**
	120	12,401	**1,812**
	$7,376	$(4,929)	**$1,642**

13. Concentrations

In 2000, 2001, and 2002, one customer for human growth hormone ("hGH"), located solely in Japan, represented $12,975,000, $16,292,000, and $12,331,000, or 17%, 17%, and 12% of revenues, respectively. In 2000, 2001, and 2002, one customer for Oxandrin and Delatestryl, located solely in the United States, represented $33,422,000, $43,718,000, and $45,625,000, or 45%, 46%, and 47% of revenues, respectively. In 2001 and 2002, one additional customer for Oxandrin, located solely in the United States, represented $10,383,000 and $6,595,000, or 11% and 6%, of revenues, respectively. In 2002, the Company's product sales consisted primarily of sales of Oxandrin, Delatestryl, hGH, BioLon, and oral liquid products in the amount of approximately $45,861,000, $20,564,000, $15,595,000, $6,696,000, and $6,346,000, or 48%, 21%, 16%, 7%, and 7% of total product sales, respectively. One customer accounted for 36% and 33% of total accounts receivable, respectively, as of December 31, 2001 and 2002. Another customer accounted for 34% and 10% of total accounts receivable, respectively, as of December 31, 2001 and 2002. Another customer accounted for 16% of total accounts receivable as of December 31, 2002. From July 2001 until March 2003, BTG had no supplier for its Delatestryl product, and BTG currently expects that its current inventory of Delatestryl will run out during 2003, with the exact timing depending on demand and its allocation of inventory. BTG cannot sell Delatestryl manufactured by its new supplier until FDA approval is obtained, and does not expect that the new supplier will be in a position to supply Delatestryl to BTG prior to BTG running out of its current Delatestryl inventory.

14. Income Taxes

The components of current and deferred income tax expense (benefit) are as follows:

in thousands Years ended December 31	2000	2001	**2002**
Current:			
State	$ 647	$ 1,067	**$ 984**
Federal	6,302	12,959	**3,040**
Foreign	1,152	1,891	**1,876**
	8,101	15,917	**5,900**
Deferred:			
State	(183)	(463)	**(100)**
Federal	(3,362)	(10,164)	**(1,140)**
Foreign	(758)	(557)	**403**
	(4,303)	(11,184)	**(837)**
Total income tax expense	$ 3,798	$ 4,733	**$ 5,063**

The domestic and foreign components of income (loss) before income taxes and cumulative effect of change in accounting principle are as follows:

in thousands Years ended December 31	2000	2001	**2002**
Domestic	$ 9,423	$(32,519)	**$ 7,593**
Foreign	3,318	6,606	**7,181**
	$12,741	$(25,193)	**$14,780**

Reconciliation of income taxes between the statutory and effective tax rates on income before income taxes is as follows:

in thousands Years ended December 31	2000	2001	**2002**
Income tax at U.S. statutory rate	$ 4,459	$ (8,818)	**$ 5,172**
State and local income taxes (net of federal benefit)	302	386	**564**
Non-deductible expenses	317	428	**263**
Research and experimental credit	(720)	(1,229)	**(812)**
Foreign income subject to a reduced rate of tax	(756)	(1,928)	**(510)**
In-process research and development acquired	—	15,504	**—**
Goodwill amortization	—	(1,066)	**—**
Foreign taxes in respect of previous years	—	1,530	**519**
Foreign compensation	557	358	**—**
Foreign tax benefit	—	(759)	**—**
Other	(361)	127	**(133)**
Income tax expense	$ 3,798	$ 4,733	**$ 5,063**

In 2002, BTG-Israel concluded a tax audit for the fiscal years 1997 through 2000. As a result, the Company has recorded in the years ended December 31, 2001 and 2002, a provision for additional tax liabilities for those years.

The components of deferred income tax assets (liabilities) are as follows:

in thousands December 31	2001	**2002**
Net operating loss carryover	$ 6,843	**$ 5,599**
Capital loss carryover	1,014	**1,047**
Research and experimental credit	2,067	**2,516**
Valuation of securities	3,600	**4,443**
Deferred revenues	3,778	**4,119**
Accrued amounts	2,803	**3,037**
Other	(226)	**—**
	19,879	**20,761**
Depreciation and amortization	(113)	**(24,141)**
	$19,766	**$ (3,380)**

At December 31, 2002, BTG had a capital loss carryover of approximately $2,800,000 available to offset future capital gains, which expires at various times with respect to various amounts through 2007, a net operating loss carryover of approximately $15,000,000 available to offset future taxable income in limited amounts per year, which expires at various times with respect to various amounts through 2021, and a research and experimental credit carryover of approximately $2,500,000 available to reduce future income taxes, which expires at various times with respect to various amounts through 2022.

The Company anticipates using tax-planning strategies to utilize its capital loss carryforwards. These tax-planning strategies have been considered by the Company when determining the need for a valuation allowance. Although realization is not assured, management believes it is more likely than not that all the deferred tax assets will be realized. Accordingly, the Company believes that no valuation allowance is required.

Provision for income taxes has not been made for U.S. or additional foreign taxes on undistributed earnings of foreign subsidiaries. Those earnings have been and will continue to be permanently reinvested. It is not practicable to determine the amount of additional tax that might be payable on the foreign earnings. The cumulative amount of reinvested earnings was approximately $13,000,000 at December 31, 2002.

15. International Operations

The Company's operations are treated as one operating segment as it only reports profit and loss information on an aggregate basis to chief operating decision makers of the Company. Information about the Company's operations in the United States, Israel, and the United Kingdom is presented below:

in thousands of U.S. dollars	U.S.	Israel	U.K.	Eliminations	Consolidated
Year Ended December 31, 2000:					
Revenues[1]	$ 62,483	$ 10,278			$ 72,761
Intercompany transactions	1,272	4,009		(5,281)	
Reimbursement of subsidiary's expenses		12,712		(12,712)	
Depreciation and amortization	1,389	1,472			2,861
Other income, net	7,369	7			7,376
Income tax expense	3,719	79			3,798
Net income	(1,815)	2,061		519	765
Identifiable assets[2]	175,555	45,921		(11,516)	209,960
Foreign liabilities[2]		28,034[3]			28,034
Investment in subsidiaries (cost basis)	15,298			(15,298)	
Year Ended December 31, 2001:					
Revenues[1]	$ 82,182	$ 12,592			$ 94,774
Intercompany transactions	318	4,863		(5,181)	
Reimbursement of subsidiary's expenses		13,498		(13,498)	
Depreciation and amortization	1,376	1,561			2,937
Other income (expense), net	(5,080)	151			(4,929)
Income tax expense	3,398	1,335			4,733
Net income	(35,205)	4,612		667	(29,926)
Identifiable assets[2]	189,415	61,261		(15,590)	235,086
Foreign liabilities[2]		32,639[3]			32,639
Investment in subsidiaries (cost basis)	15,298			(15,298)	
Year Ended December 31, 2002:					
Revenues[1]	**$ 86,460**	**$10,160**	**$ 6,346**		**$102,966**
Intercompany transactions	**30**	**4,354**		**(4,662)**	
Reimbursement of subsidiary's expenses		**14,808**		**(14,808)**	
Depreciation and amortization	**1,119**	**1,419**	**163**		**2,701**
Other income (expense), net	**2,189**	**(590)**	**43**		**1,642**
Income tax expense	**2,784**	**2,026**	**253**		**5,063**
Net income (loss)	**5,853**	**2,832**	**1,140**	**(108)**	**9,717**
Identifiable assets[2]	**90,021**	**72,971**	**14,492**	**107,947**	**285,431**
Foreign liabilities[2]		**32,338**[3]	**5,000**		**37,338**
Investment in subsidiaries (cost basis)	**119,842**			**(119,842)**	

1. Includes sales to countries outside the United States of $27,514,000, $31,665,000, and $32,725,000 in 2000, 2001, and 2002, respectively, of which $12,975,000, $16,292,000, and $12,331,000, respectively, are sales to Japan.

2. At year end.

3. Excludes liability to parent.

16. Quarterly Data

Following are the quarterly results of operations for the years ended December 31, 2001 and 2002.

unaudited in thousands, except per share data	March 31 2001	March 31 **2002**	June 30 2001	June 30 **2002**	September 30 2001	September 30 **2002**	December 31 2001	December 31 **2002**
Revenues:								
Product sales	$ 29,887	**$18,938**	$25,303	**$23,205**	$15,541	**$24,719**	$16,375	**$29,245**
Contract fees	414	**564**	415	**414**	414	**262**	413	**564**
Other	1,064	**1,346**	1,037	**1,481**	2,395	**1,252**	1,517	**976**
	31,365	**20,848**	26,755	**25,100**	18,350	**26,233**	18,305	**30,785**
Expenses:								
Research and development	5,927	**8,935**	8,866	**8,208**	5,847	**6,778**	7,137	**8,862**
Marketing and sales	4,741	**4,449**	4,557	**4,816**	3,046	**5,200**	4,662	**7,679**
General and administrative	3,272	**3,225**	3,679	**3,566**	2,977	**4,082**	3,324	**6,708**
Cost of product sales	3,524	**3,171**	3,819	**3,489**	2,710	**3,097**	2,335	**4,391**
Amortization of negative goodwill associated with acquisitions	—	**—**	(1,082)	**—**	(959)	**—**	(919)	**1,013**
Other	46,246	**683**	265	**412**	533	**435**	525	**629**
	63,710	**20,463**	20,104	**20,491**	14,154	**19,592**	17,064	**29,282**
Operating income (loss)	(32,345)	**385**	6,651	**4,609**	4,196	**6,641**	1,241	**1,503**
Other income (expense), net	2,260	**928**	1,577	**(1,012)**	1,797	**1,478**	(10,570)	**248**
Income (loss) before income taxes	(30,085)	**1,313**	8,228	**3,597**	5,993	**8,119**	(9,329)	**1,751**
Income tax expense (benefit)	4,820	**324**	2,279	**1,236**	1,443	**2,465**	(3,810)	**1,038**
Net income (loss)	$(34,905)	**$ 989**	$ 5,949	**$ 2,361**	$ 4,550	**$ 5,654**	$ (5,519)	**$ 713**
Earnings (Loss) per Common Share:								
Basic	$ (0.63)	**$ 0.02**	$ 0.10	**$ 0.04**	$ 0.08	**$ 0.10**	$ (0.09)	**$ 0.01**
Diluted	$ (0.63)	**$ 0.02**	$ 0.10	**$ 0.04**	$ 0.08	**$ 0.10**	$ (0.09)	**$ 0.01**
Weighted Average Number of Common and Common Equivalent Shares:								
Basic	55,117	**58,305**	57,388	**58,403**	58,078	**58,531**	58,294	**58,678**
Diluted	55,117	**58,649**	58,899	**58,498**	59,411	**58,578**	58,294	**58,716**

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Stock Listing

Bio-Technology General Corp. is traded on the NASDAQ National Market.
NASDAQ Symbol: BTGC

Form 10-K

Bio-Technology General Corp. Form 10-K, filed with the Securities and Exchange Commission for the year ended December 31, 2002, is available to stockholders, without charge, via the Company's website or upon written request to the Secretary of the Company.

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