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

Financial Condition and Liquidity

During fiscal 2001 net current assets increased by \$226,388,000. Increases in cash, accounts receivable, inventories and accrued expenses resulted primarily from increases in sales, particularly Celexa™. Celexa (citalopram HBr) is the Company's selective serotonin reuptake inhibitor ("SSRI") for the treatment of depression. Inventory levels have increased to meet the growing demand for Celexa. During the year, the Company increased its investment in long-term marketable securities in order to receive more favorable rates of return on invested funds. The increase in license agreements, product rights and other intangible assets was due to several late-stage product license agreements entered into by Forest during the period. These agreements include dexloxiplumide for the treatment of irritable bowel syndrome, lercanidipine for the treatment of hypertension and memantine for the treatment of Alzheimer's Disease and neuropathic pain. The increases in capital in excess of par and refundable income taxes were due to the exercise of stock options by employees along with related tax benefits.

Property, plant and equipment increased as the result of expansions of the Company's facilities and the acquisition of new facilities to meet current and projected future product demand. Included was an expansion of Forest's Irish manufacturing facility and the acquisition of new facilities on Long Island, New York for research and development, sales support and warehousing and distribution. Further expansions and acquisitions are likely to meet the needs of increased production and research and development.

Management believes that current cash levels, coupled with funds to be generated by ongoing operations, will continue to provide adequate liquidity to facilitate potential acquisitions of products and capital investments.

Results of Operations

Net sales in fiscal 2001 increased \$301,705,000 to \$1,174,527,000, a 35% increase from fiscal 2000. Forest's leading product, Celexa, accounted for most of the increase with sales amounting to \$714,359,000, an increase of \$287,017,000 or 67% from last year. Since its launch, Celexa has continued to experience strong growth and, as of March 31, 2001, had captured a 14.2% share of total prescriptions in the SSRI market. Tiazac®, which continues to experience volume growth, increased \$18,665,000 in fiscal 2001 of which \$27,136,000 was due to volume increases, offset by \$8,471,000 of net price declines which

were principally the result of increases in government sales at a discount. Sales of Infasurf®, Forest's lung surfactant for the prevention and treatment of respiratory distress syndrome in premature infants, which was launched during the third quarter of fiscal 2000, amounted to \$12,886,000, and accounted for \$8,093,000 of the increase. Sales of Aerobid®, which continues to experience competition in the inhaled steroid market, declined \$2,146,000 or 3% during fiscal 2001 due to volume declines. Sales of Forest's generic products increased by \$9,151,000 from fiscal 2000. The remainder of the net sales change was due principally to volume declines on the Company's older unpromoted product lines. Net sales in fiscal 2000 increased \$326,556,000 or 60% as compared to fiscal 1999. Celexa had the biggest impact on the sales increase, capturing a total prescription market share of 10.5% in the SSRI market. During fiscal 2000, sales of Celexa were \$427,342,000, an increase of \$335,432,000 from fiscal 1999, the year it was launched. Infasurf, launched in October 1999, achieved sales of \$4,794,000 in fiscal 2000. Tiazac increased \$28,495,000 or 22% in fiscal 2000. Sales of Aerobid, declined \$28,693,000 or 31% in fiscal 2000 as compared to fiscal 1999. Sales of our other products decreased \$17,403,000 or 8% from fiscal 1999 due primarily to volume declines.

The increase in other income during fiscal 2001 as compared to fiscal 2000 was due to increases in interest income as a result of more funds available for investment. Included in other income is contract revenue, which represents royalties on sales of Climara®, a transdermal estrogen product, which amounted to \$6,827,000, \$8,976,000 and \$12,848,000 in fiscal years 2001, 2000 and 1999, respectively. Other income in fiscal years 2000 and 1999 included \$3,000,000 and \$12,000,000, respectively, from the settlement with Pharmacia & Upjohn, Inc. with respect to the Company's claimed option to negotiate for the rights to Detrol®. In fiscal 1999 other income also included \$38,387,000 from our arrangement with a private investor group to reimburse Forest for certain expenses incurred in connection with Celexa (refer to Note 12 of the consolidated financial statements). The balance of other income for fiscal 2000 and fiscal 1999 was principally interest earned on invested funds.

Cost of sales as a percentage of sales was 24% in fiscal 2001 as compared to 25% in fiscal years 2000 and 1999. The decrease was due to an increase in overall plant utilization and to product mix as Celexa, with a lower cost of goods, comprised a larger portion of total sales.

Selling, general and administrative expenses increased \$60,751,000 during fiscal 2001 due primarily to activities related to Celexa, including our newly expanded salesforce. During the second half of fiscal 2000, we increased the salesforce by almost 70%, from 850 representatives and managers to 1,425 persons. This expansion was necessitated by the termination of the co-promotion arrangement with the Warner-Lambert Company on April 30, 2000. A termination payment of \$14,000,000 was paid to Warner-Lambert during the first quarter that ended Warner-Lambert's co-promotion activities with respect to Celexa and entitlement to future compensation therefor. The increase in selling, general and administrative expenses in fiscal 2000 as compared to fiscal 1999 was principally due to marketing, promotional and selling activities related to Celexa, including co-promotion fees payable to Warner-Lambert. No co-promotion fees were earned in fiscal 1999. During the third and fourth quarters of fiscal 2000, the Company incurred both the costs of the increased salesforce and the co-promotion fees to Warner-Lambert. During fiscal 1999, a portion of pre-launch and launch costs, together with certain research and development expenses related to Celexa, were reimbursed by the private investor group as discussed above.

The increase in research and development expense during each of the years presented was due to costs associated with clinical trials conducted to obtain approval for new products and from staff increases and associated costs required to support currently marketed products and products in various stages of development. During the current year, particular emphasis was placed on clinical studies for escitalopram, Forest's single enantiomer form of Celexa, for which Phase III clinical trials have been completed and a New Drug Application ("NDA") was filed with the FDA during the fourth quarter. The Company also incurred expenses related to the licensing of early-stage development products. During the first quarter of fiscal 2001 the Company filed an NDA for flunisolide HFA for the treatment of asthma, for which we received an approvable letter from the FDA. As a result of the completion of several licensing agreements during fiscal 2001, the Company anticipates further increases in research and development expenses for next year and beyond. Other products in our pipeline for which we expect to file NDA's during the upcoming year include: lercanidipine, for the treatment of hypertension; our patented combination of oxycodone/ibuprofen for moderate to severe pain; and memantine, for the treatment of Alzheimer's Disease and neuropathic pain. Forest has several other on-going clinical

trials in various stages including siramesine for anxiety, dexloxyglumide for the treatment of irritable bowel syndrome, ML3000 for osteoarthritis, and ALX-0646 for the treatment of migraine headaches.

Income tax expense as a percentage of income before taxes was 28% for the current year, unchanged from fiscal 2000, and 30% in fiscal 1999. The decrease from fiscal 1999 resulted principally from a decrease in the proportion of operating profit derived from fully taxable U.S. operations as compared to lower taxed operations. Celexa is licensed and manufactured in Ireland and a portion of its profits are subject to a favorable tax rate.

The Company expects to continue its profitability into fiscal 2002 with continued growth in its principal promoted products.

Inflation has not had a material effect on the Company's operations for the periods presented.

Forward Looking Statements

Except for the historical information contained herein, the Management Discussion and other portions of this annual report contain forward looking statements that involve a number of risks and uncertainties, including the difficulty of predicting FDA approvals, acceptance and demand for new pharmaceutical products, the impact of competitive products and pricing, the timely development and launch of new products and the risk factors listed from time to time in the Company's SEC reports, including the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2001.

Quantitative and Qualitative Disclosures About Market Risk

In the normal course of business, operations of the Company may be exposed to fluctuations in currency values and interest rates. These fluctuations can vary the costs of financing, investing and operating transactions. Because the Company had no debt and only minimal foreign currency transactions, there was no material impact on earnings of fluctuations in interest and currency exchange rates.