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New Rec: Alpharma	(ALO \$52.06)	September 6, 2000
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Position: Sell **Target: \$26** **Timing: 2 (1=aggressive; 5=cautious)**

000\$	3Q00e	4Q00e	1Q01e	2Q01e	2000e	2001e
Revs	266,612	278,571	243,009	249,461	953,073	1,052,420
EPS	0.49	0.53	0.43	0.44	1.75	1.92
Y/Y Gr%	32%	30%	23%	29%	31%	10%
PE					30	27
PSR					2.68	2.43
Consens	0.49	0.55	0.45	0.46	1.76	2.25

Shs Out: 49.1 M* **Mkt Cap: \$2.6 B** **FYE: Dec.**

* Includes recent share offering and conversion of convertible debt.

Summary: Alpharma is a "hybrid" generic pharmaceutical company which manufactures, markets, and distributes products for use by humans and animals. With its May 2000 acquisition of Roche's medicated feed additive (MFA) business, about 58% of the company's revenue comes from sales of human pharmaceuticals, mainly liquids and topical products, 36% from sales of animal pharmaceuticals, with a significant exposure to antibiotic additives to animal feed, and 7% from sales of fine chemicals.

Alpharma has beaten earnings estimates for the last 14 quarters, according to management. ALO's share price has risen by about 100% from December 1999. "Street" analysts claim that ALO's "organic" revenue growth is 10%-15%. However, a closer analysis of revenue growth reveals that organic sales growth has declined since 1998 and is now about flat. Core earnings growth also appears to be weak, in mid single digits.

Management is guiding the "street" to an EPS increase of 30% in F2001, up from the 25% previous guidance, as a result of the recent Roche MFA acquisition. EPS is projected to be \$1.75 in 2000 and \$2.25 in 2001 with sales increasing by 18% and with net margins increasing by 140 basis points over 2000 to 8.1% in 2001. However, an analysis of the Alpharma's core business reveals that EPS has actually been growing at about 7% in 1999 and in Q2 00. EPS growth in excess of 7% is due to a lucky "windfall" in 1999, and a well planned and highly accretive acquisition in Q2 00, which we view as a one time event.

An analysis of the pro forma revenue statements in the 1998 and 1999 10Ks and in the Q1 00 and Q2 00 10Qs reveals that while on a pro forma basis revenue increase by 8% in 1998 over 1997, pro forma sales growth slowed to 6% in 1999 versus 1998, and to 5% in Q1 00 versus Q1 99, and pro forma revenue growth actually turned negative in Q2 00 versus Q2 99, coming in at a negative 5%. By contrast, reported year over year revenue growth was 21% in 1998, 23% in 1999, 20% in Q1 00, and 34% in Q2 00.

As a result, it appears that ALO is not growing core revenues and is buying businesses that are also not growing. Increasing earnings per share is coming from "rationalizing" the slow growing businesses that it acquires.

An analysis of reported results in 1999 and in Q2 00 should give investors pause. In 1999 ALO was a major beneficiary of a one time event related to its Cox business in the UK. The 1999 10K provides some detail.

Information from the 10K reveals that the Cox business contributed about \$125M in revenue and \$28.9M in operating profit, a 23% margin. However, in 1998 the Cox business generated only 8% operating margins, and in 1999 in the first four months the business generated 13% margins. The last eight months of 1999, however, provided operating margins of 27%. This was strictly due to a rise in prices in the UK generics market. In March 2000 the UK launched an investigation into the pricing of generics, and has rolled back pricing to early 1999 levels with price controls as of Aug. 3, 2000. By our calculation, provided in detail below, the price increase in 1999 added \$0.27 to ALO's reported diluted EPS. As a result, without the UK price increase, we estimate that ALO would have reported EPS of \$1.07 in 1999 versus \$1.03 in 1998, a 4% increase. Sometimes its better to be lucky than smart.

Q1 00 was a continuation of the situation experienced in the second half of 1999. However, by Q2 pricing and volume in the UK market had begun its decline, and the company reported that pricing and volume, while still better than Q2 99, was not as good as it was in the second half of 1999, and by extension Q1

00. Yet, ALO was still able to meet estimates in Q2, and posted EPS of \$0.34 versus \$0.28 in Q2 99.

Q2 00 results were more a result of being smart than lucky. However, a close analysis of Q2 00 reveals that all was not well at ALO, and that the company saved the quarter with the acquisition of Roche, aided by some clever financial maneuvering. Q2 reported sales were \$219.5M, and reported operating income was \$31.2M. This compares to Q1 reported sales of \$188M and operating income of \$27.1M. However, \$37.7M of the increase came from Roche, so without the increase from Roche sales declined sequentially to \$184M in Q2. Part of the reason for the decline was lower selling prices, and therefore lower margins at the UK Cox division, which we noted above.

With lower sales and lower margins, how did ALO manage to increase operating income by \$4.1M? The answer appears to lie with the Roche acquisition, which closed on May 2. Using information provided in the Roche acquisition 8K and the Q2 10Q we estimate that ALO was able to book \$37.7M in sales in Q2, which was about 85% of the total sales that the Roche business actually achieved for the whole of Q2, despite the fact that ALO owned the division for only two months. Of course, ALO booked only two months of expenses, or about 67% of the quarter's expenses. We estimate the incremental SG&A booked by ALO due to Roche in Q2 at about \$4M. As a result, we estimate that the Roche acquisition provided about \$7M in additional EBT to ALO's income statement in Q2. Without Roche, operating income, which was reported to have increased by \$4.1M, would have declined by about \$2.9M sequentially. This means that ALO would have reported EPS of \$0.30 in Q2 00, versus \$0.28 in Q2 99, up only 7%.

In our view, this is what is really going on at Alpharma. Core EPS growth in Alpharma's businesses appears to be anemic, only in the mid single digits. Alpharma can boost EPS with acquisitions, but these are one time events, and these acquired companies are also not growing. If investors understood that Alpharma was really a business with slow or no sales growth and EPS growth only in mid single digits, would they be likely to pay 30x forward earnings?

Alpharma gives guidance on EPS growth, but appears to offer curiously little guidance on revenue. In our opinion, the reason is that ALO management is hoping to make the earnings numbers through rationalization of acquired businesses and not by sales growth. This is what is missed by the "street". As a result, we think that ALO revenues will be short of consensus projections, but EPS results will be closer to projections, for a while, although there will be a great risk in even lower sales than we anticipate. However, by the second half of 2001 it should be very clear that Alpharma is growing EPS at only about 5%, as the Roche acquisition is lapped. Of course, Alpharma will try to overcome this looming problem with more acquisitions. However, the Roche acquisition was very large, adding 25% to 30% to revenues. It will be very difficult to keep this game up, and the execution risk is very great.

Investors should soon see that sales are below expectations, and next year

they should see that EPS growth is in mid single digits. Only more Roche-like acquisitions can keep the reported EPS growth in double digit territory. With core growth of 7%, and reported growth perhaps of 15% with acquisitions longer term, we would value ALO shares at about 80% of the 15% growth rate. With an EPS projection in the \$2.00 range for 2001, we place a value of about \$26 on the shares.

ALO sold 4.95M shares for \$186M in May, and sold 5M shares for \$288M in August. It has \$193M of convertible debt, with a conversion price of \$28.59 and callable in April 2001. It also has \$170M convertible at \$32 and callable in June 2002. The company plans to call the \$193M in April, and as a result investors will begin to convert the bonds after the next interest payment in October. 125,000 of the debt is in public hands and \$68M is held by the controlling shareholder of Alpharma. As a result, we expect to see about 4.9M shares converted by institutional shareholders beginning October. We attribute the current short interest in the shares to holders of the debt planning to convert. We note that brokerage houses bought the last two share issues in May and in August totaling nearly 10M shares for resale. As a result of this activity short interest may rise and shares coming on the market in the near future should increase substantially.

Discussion:

Background: With its May 2000 acquisition of Roche's medicated feed additive (MFA) business, about 58% of the company's revenue comes from sales of human pharmaceuticals, mainly liquids and topical products, 36% from sales of animal pharmaceuticals, with a significant exposure to antibiotic additives to animal feed, and 7% from sales of fine chemicals.

	2000E Sales*	% of Total
Human Pharmaceuticals	\$547 M	58%
Animal Pharmaceuticals	\$343 M	36%
Fine Chemicals	\$61 M	6%

*OWS Estimates

A closer look at Alpharma's business by division reveals a group of businesses in slow growing and highly commoditized markets. Later in this report we present a table that estimates pro forma revenues and growth rates for these businesses. These tables demonstrate that year over year growth has been in single digits since 1998 and has been declining since that time.

1. The company's human pharmaceutical business is divided into an International Pharmaceutical Division (IPD) and a US Pharmaceutical Division (USPD). IPD is the larger of the two divisions, contributing 60% (\$303 M) of human pharmaceutical sales in 1999. The divisions products are generic, consist mainly of liquid and topical products, and face significant competition. The IPD product line is also highly fragmented: with 305 products in 1,100 product presentations (liquids, tablets, creams, ointments, and suppositories), the average revenue per product presentation in 1999 was only \$275 K.

IPD revenue increased 57% year over year, but only as a result of acquisitions. The core IPD business has been declining, with sales down -2% year over year in 1999. Results so far in 2000 appear to be no better. We estimate IPD core revenue declined -3% in 1H00 year over year. Looking at the division's low growth and operating margins of only 8% in 1998 (before the impact of price increases in the UK), it appears that the core IPD business consists primarily of established generic products with significant competition.

In May 1998, ALO acquired A.H. Cox, Hoechst's (now Aventis) generic business in the United Kingdom, for \$198 M, about 2 times 1997 sales. Growth for Cox was only 4% in 1998, but price increases in 1999 produced a huge surge in revenue and operating income, as we discuss in detail below. Unfortunately for ALO, these price increases have been rolled back as of August 3, 2000. Since the company's filings tell us that increased revenues for Cox in 1999 came primarily from price increases, we expect Cox' 2001 sales will be only about 12% better than in 1998.

ALO acquired ISIS Pharma GmbH from Schwarz Pharma in June 1999 for \$153 M, about 1.8 times 1998 sales. With ISIS, ALO acquired a sales force and generic product registrations, but no other assets. The business has not performed well for ALO, with sales down an estimated -22% year over year in 1999. The deterioration continued in the first half of 2000, with 1Q00 sales according to the "street" down another -8% versus pro forma sales for 1H99. Gross margins in the business were deteriorating preceding the acquisition, down from 72% in 1997 to 67% in 1998. Moreover, DSOs for the business increased from 40 days at end 1997 to 135 days at end 1998. We also note that ISIS appears to depend on a limited number of customers, with four customers accounting for 72% of revenue in 1998.

The US Pharmaceutical Division, which manufactures and markets primarily liquid and topical pharmaceuticals, contributed \$197 M in revenue in 1999. It has been one of the few bright spots in ALO's business, growing year over year by 10% year in 1999, and 17% in 1H00. Recent new product introductions contributing to this growth include the April 2000 launch of permethrin lotion 1% (comparable to Nix lice treatment), and generic Atrax syrup (anti anxiety agent), launched in May 2000. The company will launch a generic extra-strength Rogaine in November 2000, but two other competitors will also enter at that time. With branded Rogaine sales totaling only \$85 M in 1999 (a decline of 18% year over year), we do not expect this product to contribute more than \$8 M per year.

The USPD's focus on liquids has limited the products it can take generic. With no tablet manufacturing capabilities in the US, ALO is not well positioned to take advantage of the many generic product opportunities coming in 2001 and beyond. "Street" analysts suggest that ALO is looking for acquisitions in this space, but we wonder what it could afford to buy where synergies could be attained. Certainly existing generic tablet manufacturers such as Watson, Teva, and Mylan will be looking to make the same acquisitions as well.

2. The Animal Health Division (AHD) manufactures and markets medicated feed additives, antibiotics used in the commercial production of livestock, primarily swine and poultry. The core AHD business generated \$169 M in revenue in 1999, and grew 1.7% year over year, and 1.5% in 1H00. This slow growth reflects the depressed nature of the overall medicated feed additives market. As shown in the table below, the US market for medicated feed additives has been in decline for the past two years. The reasons for this decline appear to be poor market conditions in the livestock industry, as well as decreased use due to concerns that the use of antibiotics in animal feed is contributing to the emergence of drug resistant pathogens that infect humans.

	US Feed Additive Sales (M)	Y-Y % change
1997	\$620	+15%
1998	\$595	-4%
1999	\$569	-4%

Source: Animal Health Institute

Operating margins for the AHD are over 20%, even though the products are generic. We think several factors contribute to these high margins. First, there is limited competition in the medicated feed additive business. With concerns about the use of antibiotics in livestock increasing, the FDA has become more diligent in its requirements for approval of new agents. Industry sources tell us this has brought research in the area to a virtual halt, meaning that existing generic agents face little competition from improved products. Moreover, potential competitors are concerned that the bans imposed on the use of medicated feed additives in the European Union in 1999 may also be adopted in the US. This makes new entrants reluctant to invest in the market. Finally, the fermentation process required to produce these antibiotics has significant economies of scale, meaning that a significant investment would be required to enter the market.

ALO more than doubled the revenues of the AHD with the acquisition of Roche's feed additive business in May 2000 for \$288 M, about 1.4 times 1999 sales. The acquisition solidified ALO's position in the market for feed additives, particularly those containing bacitracin, an antibiotic added to the feed of swine, poultry, and calves.

While the acquisition provides a boost to revenue, we expect the expanded AHD will experience the same slow revenue growth as seen in the core AHD business. Moreover, the potential for increased regulation or an outright ban on the use of some feed additives presents a risk for ALO. The company is the world's leading producer of bacitracin. It warns in its filings that if the ban on bacitracin extends beyond the EU to countries where more bacitracin is used (presumably the US), or if the EU bans the importation of meat from livestock fed bacitracin, it could have a materially adverse effect.

The company also has a small (\$16 M in 1999 revenue) Aquatic Animal Health Division (AAHD) that manufactures and markets vaccines for farmed

fish. This business performed poorly in 1999, declining -15% year over year. The business has seen some growth in the first half of 2000, increasing 20% year over year, but still contributes negative operating income.

3. The Fine Chemical Division (FCD) manufactures active pharmaceutical ingredients for use by other manufacturers in finished dose products. Most of the division's products are antibiotics such as bacitracin, polymixin, vancomycin, and amphotericin B. The division grew 15% year over year in 1999, and contributed \$61 M in revenue. In the first half of 2000, however, division sales were down -5% year over year. It appears that the company's expansion into the US vancomycin market boosted sales in 1999, but that the division has had no additional business to boost growth further.

4. Q2 2000 was not a stellar quarter for ALO, despite reported results. As we demonstrate below, sales on a pro-forma basis, including Roche, declined year over year. Operating profit without Roche declined substantially from Q1 to Q2. Reported sales without Roche rose 11% year over year, but a part of that increase was due to higher prices in the Cox UK division, where prices are declining. On an adjusted basis, without Roche, we estimate that operating profit increased only 7% year over year, and again that result was boosted by unsustainably high Cox UK pricing.

ALO reported Q2 sales of \$219.5 M and net income excluding charges and before conversion of \$11.9M. This compares to the previous quarter's \$188.3 M and \$11.1M net income. Operating income, or EBIT, excluding one time charges, was \$31.2M, and EBT was \$18.3M.

	Q2 99	Q1 00	Q2 00
Revs 000			
reported	163839	188280	219545
minus Roche			37700
Total	163839	188280	181845
EBT			
reported	11798	17235	18309
minus Roche			7000
Total	11798	17235	11309
EPS			
Reported	0.28	0.36	0.34
minus Roche	0.28	0.36	0.30
Y/Y			7%

\$37.7 M of the revenue increase was due to the Roche acquisition, which was described as fully integrated and projected to be accretive for the year in Q2's conference call.

Excluding the Roche acquisition, then, sales actually declined sequentially from \$188.3M to \$181.8M. The interesting problem for an analyst is to determine how much ALO would have earned on a reported \$181.8M in revenue,

and to estimate how accretive or dilutive was the Roche acquisition.

The company reported that pricing had been coming down in the UK Cox business, and therefore gross margins in Q2 relative to the last half of 1999, and we assume relative to Q1 00, were down, but were still significantly higher than in Q2 1999.

The Q2 10Q reveals that IPD (international pharmaceutical division) revenue fell from \$85 M in Q1 to \$77 M in Q2. This division includes Cox. This revenue decline in the IPD division is enough to account for the whole sequential decline in revenue ex the Roche acquisition from Q1 to Q2.

The 10Q also reveals that operating income from the IPD division fell to \$12.6 M in Q2 from \$14.6 M in Q1.

Offsetting the decline in Cox sales in Q2 was an increase of \$8 M in the USPD (US Pharmaceutical division). However, the \$800,000 increase in operating income from the USPD was not enough to offset the decline in operating income from Cox. Other operating income from divisions other than AHD (animal health), in which Roche is included, was also not enough to offset the decline.

As a result, without an increased contribution from AHD, in which Roche is included, it is clear that operating income would have declined Q/Q. Therefore, the contribution from AHD increased. What caused the increase?

AHD sales rose from Q1 to Q2 from \$41.6 M to \$72.8 M. \$37.7M of the Q2 sales came from Roche (MFA), meaning that core AHD sales fell by \$6.5M to \$35.1 M. Some of this decline is due to cannibalization by the MFA line.

Since non-MFA sales declined by \$6.5 M in Q2, it is highly unlikely that the operating contribution from this business increased. Indeed, it should have decreased.

As a result it seems clear that the increased operating contribution was from Roche. This conclusion seems at odds with management's claim that the Roche acquisition was slightly dilutive to EPS in Q2.

It also seems clear that the operating income from the Roche acquisition was enough to offset a decline in operating income in the rest of the business in Q2 plus adding enough to post a profit.

Are we able to estimate the impact of Roche on operating income in Q2? If we can, it should also enable us to estimate the actual results from operations ex-Roche in Q2 for a good apples to apples comparison with Q1.

The 8K regarding the Roche acquisition when combined with the Q2 10Q appears to give us enough information to calculate the Roche impact and to understand how it was achieved.

The Roche 8K gives a pro forma income statement for 1999. We will concern ourselves only with the impact on EBIT.

1999	ALO alone (A)	Proforma Roche/MFA (B)	MFA delta (A-B)	MFA delta adjusted for cost savings*
Revs 000	742176	953190	211014	211014
Cgs	397890	548098	150208	137159
gp	344286 46%	405092 42%	60806 29%	73855 35%
sga/r&d	244775 33%	318104 33%	73329 35%	73329 35%
Op inc	99511	86988	-12523	526
op margin	13.4%	9.1%	-5.9%	0.2%
Cost savings*				-53000
sg&a after savings				20329
Op Inc				53526
Op Margin				25%

Company reports, OWS calculations

* OWS adjustments include raising gm to 35% under ALO management, and a reduction to yearly SG&A and R&D of \$53M annually which was not included in the pro forma presented by the company, but which it ALO states that it intends to achieve.

The table shows the pro-forma results that ALO would have achieved in the Roche MFA division given the company's anticipated cost reductions. At first glance, it appears that pro-forma results would have shown a decline. However, a couple more adjustments are necessary. Not included in the pro-forma was the potential elimination of allocated overhead of \$36M incurred by Roche in 1999, and the elimination of R&D of \$17M. Adding these two together, it seem that ALO could achieve additional saving of up to \$53M, reducing SG&A/R&D to as low as \$20.3 M annually. For purposes of our estimates, we assume that not all R&D could be eliminated, and that as a result ALO, by its own estimates should be able to run the MFA business for an incremental \$2M per month, \$24M per year in SG&A/R&D.

Another adjustment that should be made to understand the impact of the Roche deal is a change to gross margin. Although the pro-forma indicates a 29% gross profit on the Roche business, ALO management claimed that the Roche business entered the ALO business with a 35% gross margin, and it projected that it might achieve margins as high as 50% over time. It is difficult to know what gross margins were for the full Q2, or to project them exactly for the balance of 00 and 01, but for the moment we assume that gross margins were 35% for Q2. The adjusted pro forma results for 1999 show that under ALO management the Roche business is highly accretive.

We are now in a position to estimate the incremental operating margin contributed by Roche to Q2 ALO results. The acquisition was made May 2, so

two months of Roche are in Q2. The revenue contribution was \$37.7M, at a gross margin of 35% yields gross profit of \$13.2M. Deduct expenses of \$4M (\$2M per month, as per the pro-forma discussion above) and we get an EBIT contribution of \$9.2M from the Roche acquisition in Q2. If we deduct \$2m of added interest expense reported in Q2 versus Q1, we can now see that the Roche acquisition appears to have added about \$7M to pre-tax profit in Q2.

We also conclude from this exercise that the core business without Roche actually experienced an operating profit decline of about \$3M from Q1 to Q2. This is because ALO reported an increase of \$4.1M. ($\$7M - \$4.1M = \$2.9M$). An operating profit decline of \$2.9M at a tax rate of 35% is about \$0.045 after tax. In other words, ALO would have reported about \$0.30 EPS rather than the \$0.34 it reported. ALO reported \$0.36 in Q1 00 and \$0.28 in Q2 99, so year over year growth would have been in the order of 7%.

The Q2 10Q also provides further insight into the benefit of the acquisition. The pro-forma 3 month and 6 month tables reveal that the Roche business did \$50M in Q1, and \$44.6M in Q2, but since ALO reported \$37.7M in May and June, Roche did only \$6.95M in business in April before its acquisition. We assume that expenses were evenly spread throughout the quarter at Roche. As a result, we estimate that ALO recorded two thirds of Q2 Roche expenses, but reported 85% of Q2 sales. As a result, it appears that Roche absorbed a significant operating loss on \$6.95 M in sales in April. We note that a letter of intent had been signed between ALO and Roche sometime before the end of March, according to the 10K filed on March 29, 2000, so that the transition details may have been agreed upon before April.

From 10Qs

Revs		H1 1999pf	H1 2000pf	Change
2Q00	10Q	471700	464800	-6900

Revs		Q2 99pf	Q2 00 pf	Change
2Q00	10Q	238700	226500	-12200

Revs		Q2 00 report	Q2 00 pf	April Roche
2Q00	10Q	219545	226500	6955

Revs		H1 00 pf	Q2 00 pf	Q1 00 pf
2Q00	10Q	464800	226500	238300

Revs		Q1 00 actual	Q1 00 pf	Roche Q1
2Q00	10Q	188280	238300	50020

Revs		Roche Q1	Roche Q2	Roche H1
2Q00	10Q	50020	44655	94675

Company reports, OWS calculations.

5. Fiscal year 1999 also would not have been a stellar year for Alpharma had the Cox UK division not experienced an extraordinary windfall from a spike in generic prices in the UK. The UK government recently took steps to control these

prices, as we noted earlier. Without the price increase reported sales in 1999 would have increased 19% versus the 23% reported, operating income would have been less by about \$16M, and reported EPS would have been \$1.07 versus the \$1.34 actually reported and versus \$1.03 in 1998, which would have represented an EPS increase of only 4% year over year.

ALO purchased Cox for about \$200M in May 1998. 1997 Cox revenues were about 55M British Pounds, or \$91.4M according to the 8K, almost all of which came from UK sales. Q1 98 revenue was 13.908M BP, or \$22.9M, versus 12.440BP in Q1 1997. The 1998 10K reveals that for the 8 months that Cox was included in ALO in 1998, revenues were \$62.1M and operating income \$5.2M. As a result, it appears that full year Cox 1998 sales were approximately \$94M.

The 1999 10K reveals additional detail, which when combined with the information provided in the 1998 10K helps us understand 1999 results. In the first 4 months of 1999 Cox did \$33.8M and had operating margin of 13%. Sales growth in the first four months of 1999 was therefore about \$2M-\$3M higher than in the comparable period in 1998 before being acquired, for sales growth of about 5%-10%. The 1999 10K is a bit challenging to read, but it indicates that sales in the last 8 months of 1999 were \$90.9M and operating margin was 27%. The 10K attributes the huge sales and operating margin increase over the similar period of 1998, when sales of \$62M were recorded, primarily due to “higher pricing which resulted from conditions affecting the market, which may not continue in 2000”.

Cox	REV	opinc	op margin
1999 4 mos	33800	4500	13%
1998 8 mos	62100	5200	8%
price impact	28800	19200	67%
99 8 mos Tot	90900	24400	27%
Total 1999	124700	28900	23%
Normalized 99	101400	13182	13%
Difference	23300	15718	
Tax Rate		0.36	
After Tax		10060	
Shs Out		37362	
EPS Impact		0.27	

1999 10K MD&A, 1998 10K MD&A, OWS estimates

What caused Cox revenues to be boosted by so much in 1999 were steep price increases that occurred as a result of a loophole in the United Kingdom's generic drug pricing regulations. Under the regulations, if a shortage of a generic product existed, manufacturers could raise the price of the generic in order to encourage more supply to enter the market. As a result, manufacturers created artificial supply shortages in an estimated 190 products by November 1999. These shortages increased generic prices by 45% over the period January 1999 to April 2000, and cost the UK's National Health Service an estimated £200, or about \$300 M. In response, in April 2000 the government proposed a change in

the regulations to close the pricing loophole, and to set maximum prices for generic drugs at January 1999 levels. These maximum prices took effect on August 3, 2000.

As the debate regarding the price increases intensified in early 2000, the generic industry seems to have recognized that it had gone too far and risked further backlash. The number of "shortage" products dropped from 190 in November to 53 in April. ALO disclosed that prices at Cox dropped somewhat in 2Q00 relative to the previous three quarters, but were still higher than in 2Q99. The company has also said that volume at Cox was down in 2Q00, as pharmacists worked off stocks of higher priced generics before the new price regulations took effect. We estimate that as a result of pricing returning to the levels of early 1999, Cox revenue in 2001 will be about 12% higher than it was in 1998, or at about \$105M in 2001.

6. Pro Forma Revenue historical and projected. We built these pro forma revenue tables using the segment reporting and acquisition information provided in the company's SEC filings. The pro forma tables show Alharma revenues as if all businesses that were a part of Alharma as of Q2 00 had been included beginning in 1998. The tables show that year over year pro-forma revenue growth has been and is projected by us to be in mid single digits.

Revenue	1998	1999	2000e	2001e
Cox	94,925	124,700	113,100	106,000
<u>Other IPD</u>	<u>232,173</u>	<u>212,269</u>	<u>213,497</u>	<u>220,771</u>
IPD	327,098	336,969	326,597	326,771
USPD	178,785	197,301	223,350	244,350
FCD	53,048	60,806	61,635	64,716
AHD Core	166,343	169,194	172,202	175,646
MFA	213,000	213,000	213,034	217,295
AAHD	18,963	16,051	19,701	23,642
Net Sales	957,237	993,321	1,016,520	1,052,420

Y-Y % Change	1998	1999	2000	2001
Cox	4%	31%	-9%	-6%
<u>Other IPD</u>	<u>-2%</u>	<u>-9%</u>	<u>1%</u>	<u>3%</u>
IPD	0%	3%	-3%	0%
USPD	15%	10%	13%	9%
FCD	37%	15%	1%	5%
AHD Core	5%	2%	2%	2%
MFA	0%	0%	0%	2%
AAHD	24%	-15%	23%	20%
Net Sales	5%	4%	2%	4%

% Net Sales	1998	1999	2000	2001
Cox	10%	13%	11%	10%
<u>Other IPD</u>	<u>24%</u>	<u>21%</u>	<u>21%</u>	<u>21%</u>
IPD	34%	34%	32%	31%
USPD	19%	20%	22%	23%
FCD	6%	6%	6%	6%
AHD Core	17%	17%	17%	17%
MFA	22%	21%	21%	21%
AAHD	2%	2%	2%	2%
Net Sales	100%	100%	100%	100%

Revenue	1Q99	2Q99	3Q99	4Q99
Cox	26,700	30,912	33,188	33,901
<u>Other IPD</u>	<u>52,125</u>	<u>52,210</u>	<u>50,869</u>	<u>57,066</u>
IPD	78,825	83,122	84,057	90,967
USPD	39,436	42,315	59,421	56,129

FCD	15,433	16,019	15,331	14,023
AHD Core	40,471	35,103	40,664	52,956
MFA	53,500	57,800	50,850	50,850
AAHD	2,112	2,522	5,383	6,034
Net Sales	229,777	236,881	255,706	270,959

Y-Y % Change	1Q99	2Q99	3Q99	4Q99
Cox	16%	22%	43%	46%
<u>Other IPD</u>	-13%	-11%	-10%	0%
IPD	-5%	-1%	6%	13%
USPD	6%	8%	14%	11%
FCD	26%	18%	28%	-7%
AHD Core	4%	-9%	-3%	13%
MFA	0%	0%	0%	0%
AAHD	-43%	10%	-28%	11%
Net Sales	1%	1%	5%	9%

% Net Sales	1Q99	2Q99	3Q99	4Q99
Cox	12%	13%	13%	13%
<u>Other IPD</u>	23%	22%	20%	21%
IPD	34%	35%	33%	34%
USPD	17%	18%	23%	21%
FCD	7%	7%	6%	5%
AHD Core	18%	15%	16%	20%
MFA	23%	24%	20%	19%
AAHD	1%	1%	2%	2%
Net Sales	100%	100%	100%	100%

Revenue	1Q00	2Q00	3Q00e	4Q00e
Cox	34,100	26,000	26,500	26,500
<u>Other IPD</u>	51,051	50,862	52,790	58,795
IPD	85,151	76,862	79,290	85,295
USPD	43,859	51,941	64,421	63,129
FCD	15,859	14,954	16,098	14,724
AHD Core	41,577	35,133	41,477	54,015
MFA	50,000	50,000	58,867	54,167
AAHD	2,981	3,020	6,460	7,241
Net Sales	239,427	231,910	266,612	278,571

Y-Y% Change	1Q00	2Q00	3Q00	4Q00
Cox	28%	-16%	-20%	-22%
<u>Other IPD</u>	-2%	-3%	4%	3%
IPD	8%	-8%	-6%	-6%
USPD	11%	23%	8%	12%
FCD	3%	-7%	5%	5%
AHD Core	3%	0%	2%	2%
MFA	-7%	-13%	16%	7%
AAHD	41%	20%	20%	20%
Net Sales	4%	-2%	4%	3%

% Net Sales	1Q00	2Q00	3Q00	4Q00
Cox	14%	11%	10%	10%
<u>Other IPD</u>	21%	22%	20%	21%
IPD	36%	33%	30%	31%
USPD	18%	22%	24%	23%
FCD	7%	6%	6%	5%
AHD Core	17%	15%	16%	19%
MFA	21%	22%	22%	19%
AAHD	1%	1%	2%	3%
Net Sales	100%	100%	100%	100%

Revenue	1Q01	2Q01	3Q01	4Q01
Cox	26,500	26,500	26,500	26,500
<u>Other IPD</u>	53,012	52,859	54,502	60,398
IPD	79,512	79,359	81,002	86,898
USPD	49,859	56,941	69,421	68,129
FCD	16,652	15,702	16,902	15,460

AHD Core	42,409	35,836	42,307	55,095
MFA	51,000	58,000	53,044	55,250
AAHD	3,577	3,624	7,752	8,689
Net Sales	243,009	249,461	270,428	289,522

Y/Y% Change	1Q01	2Q01	3Q01	4Q01
Cox	-22%	2%	0%	0%
<u>Other IPD</u>	4%	4%	3%	3%
IPD	-7%	3%	2%	2%
USPD	14%	10%	8%	8%
FCD	5%	5%	5%	5%
AHD Core	2%	2%	2%	2%
MFA	2%	16%	-10%	2%
AAHD	20%	20%	20%	20%
Net Sales	1%	8%	1%	4%

% Net Sales	1Q01	2Q01	3Q01	4Q01
Cox	11%	11%	10%	9%
<u>Other IPD</u>	22%	21%	20%	21%
IPD	33%	32%	30%	30%
USPD	21%	23%	26%	24%
FCD	7%	6%	6%	5%
AHD Core	17%	14%	16%	19%
MFA	21%	23%	20%	19%
AAHD	1%	1%	3%	3%
Net Sales	100%	100%	100%	100%

7. Historical income statements and estimates. Assumptions behind projections:

In making our revenue projections for ALO, we have assumed that the IPD core business continues to contract, declining -2% year over year. We have further assumed that the Cox business returns to pricing levels present in early 1999, and that volume goes up about 5% year over year in 2001. In USPD, we have assumed that, in addition to the continued revenue boost seen in 2Q00 from the Nix and Atrax product launches, the November launch of minoxidil boosts revenue in 4Q00 by about \$3 M, and by \$8 M year over year in 2001. Total USPD increases by about 9% year over year in 2001. We have assumed that the FCD grows at 5% year over year, and that the AHD and Roche MFA businesses grow at 2% per year. We assume that the AAHD continues to track at its 2Q00 growth rate of 20% year over year.

In developing our gross margin projections, we assumed that the business not including the MFA acquisition remains at the 48% gross margins seen in 1Q00. We have assumed that the MFA gross margin improves from the 35% mentioned by the company as the margin when MFA entered the ALO business. We quickly raise the gross margin to 40% in 3Q00, and to 50% in Q4 and for all of 2001. ALO management has said that it believed that it could eventually achieve the 50% margins it claims for its core AHD business. We think that management is underplaying the rapidity with which it will achieve these margins in order to make the rest of its businesses appear healthier.

We assume that a full quarter of depreciation of the Roche acquisition increases depreciation and amortization to about \$17.5 M in 3Q00, and that R&D runs at \$11-\$12 M per quarter going forward. Our SG&A estimates are lower than the "street," as we expect that the company has lower expenses with the Roche business than analysts expect. As a result, our operating margin projections is better than "street" expectations. This should allow ALO to meet

near term earnings expectations even on lower revenue.

Our interest expense and share count projections take into account the 5 M share offering completed in August 2000, with net proceeds of \$288 M. Finally, we have adjusted income to assume full conversion of the company's subordinated debt, adding back \$3.8M per quarter in after tax interest and amortization.

Income Statement	1998	1999	2000e	2001e
IPD Core	129,065	126,510	123,177	120,714
Cox (5/98)	62,041	124,700	113,100	106,000
Siga (11/98)	2,000	9,000	11,200	12,000
Jumer (4/16/99)	0	7,013	13,500	18,500
Isis (6/15/99)	-	36,000	65,620	69,557
Total IPD	193,106	303,223	326,597	326,771
USPD	178,785	197,301	223,350	244,350
FCD	53,048	60,806	61,635	64,716
AHD Core	166,343	169,194	172,202	175,646
MFA (5/00)	-	-	150,734	217,294
AAHD	18,963	16,051	19,701	23,642
Unalloc/elim	-5,661	-4,429	-1,147	0
Net Sales	604,584	742,176	953,073	1,052,420
COGS	350,024	397,890	505,574	542,912
SG&A	111,780	154,189	184,833	209,700
Deprec/Amort	38,120	50,418	66,157	68,600
R&D	36,064	40,168	44,000	49,000
Tot Exp	535,988	642,665	800,564	870,212
Op Inc	68,596	99,511	152,444	182,207
Int Exp	(25,613)	(39,174)	-49,173	-48,969
Other, Net	(400)	1,450	821	0
EBT	42,583	61,787	104,092	133,238
Taxes	14,772	22,236	36,743	47,966
Net Income	27,811	39,551	67,349	85,272
Int Add-back	n/m	10,561	14,374	14,252
Amort Add-back	n/m	580	792	792
Adj Net Income	27,811	50,692	82,642	100,316
Diluted EPS	1.03	1.34	1.75	1.92
Dil Shares	27,885	37,520	47,193	52,289
Y-Y % chng	1998	1999	2000	2001
IPD Core	-4%	-2%	-3%	-2%
Cox (5/98)	-	101%	-9%	-6%
Siga (11/98)	-	350%	24%	7%
Jumer (4/16/99)	-	-	92%	37%
Isis (6/15/99)	-	-	82%	6%
Total IPD	44%	57%	8%	0%
USPD	15%	10%	13%	9%
FCD	37%	15%	1%	5%
AHD Core	5%	2%	2%	2%
MFA (5/00)	-	-	-	44%
AAHD	24%	-15%	23%	20%
Unalloc/elim	267%	-22%	-74%	-100%
Net Sales	21%	23%	28%	10%
COGS	21%	14%	27%	7%
SG&A	10%	38%	20%	13%
Deprec/Amort	23%	32%	31%	4%
R&D	12%	11%	10%	11%
Tot Exp	18%	20%	25%	9%

Op Inc	46%	45%	53%	20%
Int Exp	38%	53%	26%	0%
Other, Net	-29%	-463%	-43%	-100%
EBT	53%	45%	68%	28%
Taxes	43%	51%	65%	31%
Net Income	60%	42%	70%	27%
Int Add-back	n/m	n/m	36%	-1%
Amort Add-back	n/m	n/m	37%	0%
Adj Net Income	60%	82%	63%	21%
Diluted EPS	34%	30%	31%	10%
% Net Sales	1998	1999	2000	2001
IPD Core	21%	17%	13%	11%
Cox (5/98)	10%	17%	12%	10%
Siga (11/98)	0%	1%	1%	1%
Jumer (4/16/99)	0%	1%	1%	2%
Isis (6/15/99)	0%	5%	7%	7%
Total IPD	32%	41%	34%	31%
USPD	30%	27%	23%	23%
FCD	9%	8%	6%	6%
AHD Core	28%	23%	18%	17%
MFA (5/00)	0%	0%	16%	21%
AAHD	3%	2%	2%	2%
Unalloc/elim	-1%	-1%	0%	0%
Net Sales	100%	100%	100%	100%
COGS	58%	54%	53%	52%
SG&A	18%	21%	19%	20%
Deprec/Amort	6%	7%	7%	7%
R&D	6%	5%	5%	5%
Tot Exp	89%	87%	84%	83%
Op Inc	11%	13%	16%	17%
Int Exp	-4%	-5%	-5%	-5%
Other, Net	0%	0%	0%	0%
EBT	7%	8%	11%	13%
Taxes	2%	3%	4%	5%
Net Income	5%	5%	7%	8%
Int Add-back	n/m	1%	2%	1%
Amort Add-back	n/m	0%	0%	0%
Adj Net Income	5%	7%	9%	10%
Income Statement	1Q99	2Q99	3Q99	4Q99
IPD Core	31,445	31,530	28,969	34,566
Cox (5/98)	26,700	30,912	33,188	33,900
Siga (11/98)	2,000	2,000	2,500	2,500
Jumer (4/16/99)	-	1,613	2,400	3,000
Isis (6/15/99)	-	2,000	17,000	17,000
Total IPD	60,145	68,055	84,057	90,966
USPD	39,436	42,315	59,421	56,129
FCD	15,433	16,019	15,331	14,023
AHD Core	40,471	35,103	40,664	52,956
MFA (5/00)	-	-	-	-
AAHD	2,112	2,522	5,383	6,034
Unalloc/elim	-838	(175)	(1,725)	(1,691)
Net Sales	156,759	163,839	203,131	218,447
COGS	88,367	90,028	108,838	110,657
SG&A	29,447	31,390	40,563	52,789
Deprec/Amort	10,582	11,311	14,059	14,466
R&D	10,042	10,042	10,042	10,042
Tot Exp	138,438	142,771	173,502	187,954
Op Inc	18,321	21,068	29,629	30,493

Int Exp	(7,466)	(8,857)	(11,257)	(11,594)
Other, Net	943	(22)	(673)	1,202
EBT	11,798	12,189	17,699	20,101
Taxes	4,362	4,417	6,436	7,021
Net Income	7,436	7,772	11,263	13,080
Int Add-back	1,717	1,717	3,563	3,563
Amort Add-back	92	92	198	198
Adj Net Income	9,245	9,581	15,024	16,841
Diluted EPS	0.27	0.28	0.38	0.41
Dil Shares	34,429	34,600	39,986	41,065
Y-Y % chng	1Q99	2Q99	3Q99	4Q99
Net Sales	24%	17%	24%	25%
COGS	21%	14%	11%	10%
SG&A	28%	16%	46%	56%
Deprec/Amort	33%	21%	42%	33%
R&D	11%	11%	11%	11%
Tot Exp	22%	15%	20%	22%
Op Inc	37%	41%	49%	50%
Int Exp	66%	36%	51%	61%
Other, Net	-569%	-106%	79%	-686%
EBT	35%	38%	47%	55%
Taxes	32%	51%	43%	75%
Net Income	38%	32%	49%	46%
Int Add-back	n/m	n/m	n/m	n/m
Amort Add-back	n/m	n/m	n/m	n/m
Adj Net Income	71%	62%	99%	88%
Diluted EPS	39%	31%	39%	28%
% Net Sales	1Q99	2Q99	3Q99	4Q99
Net Sales	100%	100%	100%	100%
COGS	56%	55%	54%	51%
SG&A	19%	19%	20%	24%
Deprec/Amort	7%	7%	7%	7%
R&D	6%	6%	5%	5%
Tot Exp	88%	87%	85%	86%
Op Inc	12%	13%	15%	14%
Int Exp	-5%	-5%	-6%	-5%
Other, Net	1%	0%	0%	1%
EBT	8%	7%	9%	9%
Taxes	3%	3%	3%	3%
Net Income	5%	5%	6%	6%
Int Add-back	1%	1%	2%	2%
Amort Add-back	0%	0%	0%	0%
Adj Net Income	6%	6%	7%	8%
Income Statement	1Q00	2Q00	3Q 00e	4Q 00e
IPD Core	30,751	30,162	28,390	33,875
Cox (5/98)	34,100	26,000	26,500	26,500
Siga (11/98)	2,700	2,700	2,900	2,900
Jumer (4/16/99)	3,000	3,000	3,500	4,000
Isis (6/15/99)	14,600	15,000	18,000	18,020
Total IPD	85,151	76,862	79,290	85,295
USPD	43,859	51,941	64,421	63,129
FCD	15,859	14,954	16,098	14,724
AHD Core	41,577	35,133	41,477	54,015

MFA (5/00)	-	37,700	58,867	54,167
AAHD	2,981	3,020	6,460	7,241
Unalloc/elim	(1,147)	-	-	-
Net Sales	188,280	219,545	266,612	278,571
COGS	98,036	120,417	143,348	143,773
SG&A	37,729	40,004	50,500	56,600
Deprec/Amort	14,368	16,889	17,500	17,400
R&D	11,000	11,000	11,000	11,000
Tot Exp	161,133	188,310	222,348	228,773
Op Inc	27,147	31,235	44,264	49,797
Int Exp	(10,860)	(13,053)	(12,398)	(12,862)
Other, Net	948	(127)	0	0
EBT	17,235	18,055	31,866	36,935
Taxes	6,121	6,197	11,313	13,112
Net Income	11,114	11,858	20,554	23,823
Int Add-back	3,563	3,685	3,563	3,563
Amort Add-back	198	198	198	198
Adj Net Income	14,875	15,868	24,315	27,584
Diluted EPS	0.35	0.34	0.49	0.53
Dil Shares	41,990	46,000	49,140	51,640
Y-Y % chng	1Q00	2Q00	3Q00	4Q00
Net Sales	20%	34%	31%	28%
COGS	11%	34%	32%	30%
SG&A	28%	27%	24%	7%
Deprec/Amort	36%	49%	24%	20%
R&D	10%	10%	10%	10%
Tot Exp	16%	32%	28%	22%
Op Inc	48%	48%	49%	63%
Int Exp	45%	47%	10%	11%
Other, Net	1%	477%	-100%	-100%
EBT	46%	48%	80%	84%
Taxes	40%	40%	76%	87%
Net Income	49%	53%	82%	82%
Int Add-back	108%	115%	0%	0%
Amort Add-back	115%	115%	0%	0%
Adj Net Income	61%	66%	62%	64%
Diluted EPS	32%	25%	32%	30%
% Net Sales	1Q00	2Q00	3Q00	4Q00
Net Sales	100%	100%	100%	100%
COGS	52%	55%	54%	52%
SG&A	20%	18%	19%	20%
Deprec/Amort	8%	8%	7%	6%
R&D	6%	5%	4%	4%
Tot Exp	86%	86%	83%	82%
Op Inc	14%	14%	17%	18%
Int Exp	-6%	-6%	-5%	-5%
Other, Net	1%	0%	0%	0%
EBT	9%	8%	12%	13%
Taxes	3%	3%	4%	5%
Net Income	6%	5%	8%	9%
Int Add-back	2%	2%	1%	1%
Amort Add-back	0%	0%	0%	0%

Adj Net Income	8%	7%	9%	10%
Income Statement	1Q01	2Q01	3Q01	4Q01
IPD Core	30,136	29,559	27,822	33,197
Cox (5/98)	26,500	26,500	26,500	26,500
Siga (11/98)	2,900	2,900	3,100	3,100
Jumer (4/16/99)	4,500	4,500	4,500	5,000
Isis (6/15/99)	15,476	15,900	19,080	19,101
Total IPD	79,512	79,359	81,002	86,898
USPD	49,859	56,941	69,421	68,129
FCD	16,652	15,702	16,902	15,460
AHD Core	42,409	35,836	42,307	55,095
MFA (5/00)	51,000	58,000	53,044	55,250
AAHD	3,577	3,624	7,752	8,689
Unalloc/elim	-	-	-	-
Net Sales	243,009	249,461	270,428	289,522
COGS	125,345	128,560	139,561	149,447
SG&A	46,800	48,100	54,900	59,900
Deprec/Amort	17,300	17,200	17,100	17,000
R&D	12,000	13,000	12,000	12,000
Tot Exp	201,445	206,860	223,561	238,347
Op Inc	41,564	42,601	46,866	51,176
Int Exp	(12,242)	(12,242)	(12,242)	(12,242)
Other, Net	0	0	0	0
EBT	29,322	30,359	34,624	38,933
Taxes	10,556	10,929	12,465	14,016
Net Income	18,766	19,430	22,159	24,917
Int Add-back	3,563	3,563	3,563	3,563
Amort Add-back	198	198	198	198
Adj Net Income	22,527	23,191	25,920	28,678
Diluted EPS	0.43	0.44	0.49	0.54
Dil Shares	51,898	52,158	52,418	52,681
Y-Y % chng	1Q01	2Q01	3Q01	4Q01
Net Sales	29%	14%	1%	4%
COGS	28%	7%	-3%	4%
SG&A	24%	20%	9%	6%
Deprec/Amort	20%	2%	-2%	-2%
R&D	9%	18%	9%	9%
Tot Exp	25%	10%	1%	4%
Op Inc	53%	36%	6%	3%
Int Exp	13%	-6%	-1%	-5%
Other, Net	0%	0%	0%	0%
EBT	70%	68%	9%	5%
Taxes	72%	76%	10%	7%
Net Income	69%	64%	8%	5%
Int Add-back	0%	-3%	0%	0%
Amort Add-back	0%	0%	0%	0%
Adj Net Income	51%	46%	7%	4%
Diluted EPS	23%	29%	0%	2%
% Net Sales	1Q01	2Q01	3Q01	4Q01
Net Sales	100%	100%	100%	100%
COGS	52%	52%	52%	52%
SG&A	19%	19%	20%	21%
Deprec/Amort	7%	7%	6%	6%
R&D	5%	5%	4%	4%

Tot Exp	83%	83%	83%	82%
Op Inc	17%	17%	17%	18%
Int Exp	-5%	-5%	-5%	-4%
Other, Net	0%	0%	0%	0%
EBT	12%	12%	13%	13%
Taxes	4%	4%	5%	5%
Net Income	8%	8%	8%	9%
Int Add-back	1%	1%	1%	1%
Amort Add-back	0%	0%	0%	0%
Adj Net Income	9%	9%	10%	10%