This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
✓ **Governance:** Corporate Governance Issues

Drug Pipeline in Doubt as Insiders Rush to Get Out Forest Laboratories Inc. (NYSE:FRX)

April 20, 2007

Contact: Bob Gabele (954) 779-3974 or bgabele@3DAdvisors.com

Business Description

Forest Laboratories, Inc. and its subsidiaries, engage in the development, manufacture, and sale of branded and generic forms of ethical drug products, as well as nonprescription pharmaceutical products. Its principal products include Lexapro, a single isomer version of Celexa for the treatment of major depression; Namenda, a NMDA antagonist for the treatment of moderate to severe Alzheimer's disease; Benicar, an angiotensin receptor blocker for the treatment of hypertension; Campral for the maintenance of alcohol abstinence; and Combunox for the short-term management of acute, and moderate-to-severe pain. The Company was founded in 1956 and is based in New York City.

Key Statistics

Sector:	Last Close:	Market Cap:	Avg Vol (3m):
Healthcare	**$54.89**	**$17.45B**	**2,275,220**
Industry:	**52 Wk Range:**	**Trailing P/E:**	**Shrs Out:**
Drug Manufac. - Other	**$36.18-$57.97**	**22.77**	**317.86M**
F/T Employees:	**FYE:**	**Forward P/E:**	**Short % of Float:**
5,050	**31-Mar**	**17.71**	**2.50%**

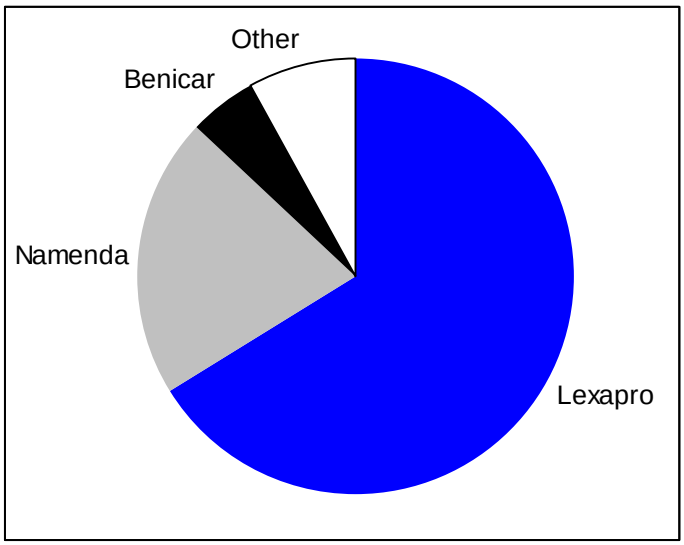
Summary of 3DAdvisors Findings for FRX

- **Fundamentals:** Threats to the Lexapro franchise in the near-term
- **Fundamentals:** Risks facing Forest's all-important drug pipeline
- **Insider Trading:** In haste to get out, insiders skim large blocks of options
- **Accounting:** Benicar seems to be running out of steam, accounting questioned
- **Accounting:** Disclosure of Lexapro/Celexa legal risks may be understated
- **Accounting:** Share repurchases halted just before Replidyne announcement
- **Accounting:** Minimal financial disclosure begs questions about earnings quality
- **Governance:** Thin and misleading disclosure extends to insider trading

Discussion of 3DAdvisors Findings for FRX

With 66% of its product sales coming from a single drug, the anti-depressant Lexapro, and 21% attributable to the Alzheimer drug Namenda and 5% to Benicar (hypertension), Forest is basically a three-product Company scrambling to replace its pipeline before the Lexapro and Namenda patents run out in 2012 and 2013, respectively. Their plans took a severe blow when, in early February, Forest unexpectedly cancelled its collaboration agreement (with Replidyne) to develop Faropenem, a highly anticipated oral treatment for pneumonia, bronchitis and sinusitis. The first warning of this development occurred back in October of 2006 when the FDA issued a Non-Approvable letter concerning Faropenem. Just afterwards, insiders began selling: In early November, **Kenneth Goodman** (59), Forest president and COO at the time, announced his retirement at year-end. He immediately sold 3 million Forest shares, or 76% of his holdings.

Figure 1. Percentage Share of Total Revenue by Drug, Fiscal Third Quarter of 2007 (Quarter Ended 12/31/06). Source: FRX SEC Filings.



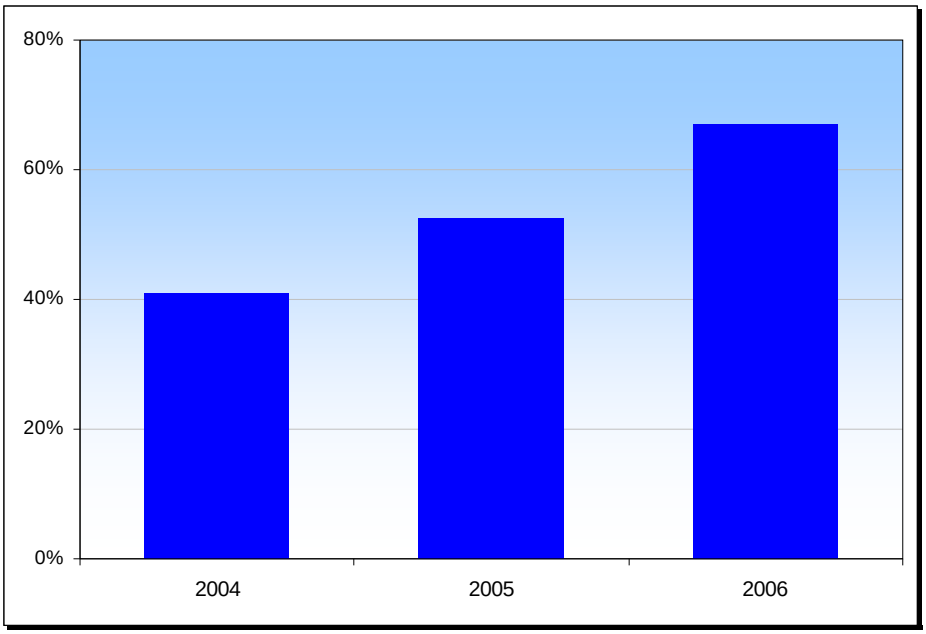
As the Faropenem issue unfolded, insider selling mounted, culminating in a flurry of aggressive distributions *after* Forest's unexpected February 6th cancellation of its development agreement with Replidyne and subsequent 11% slide in FRX shares. Not only did those involved lob off large chunks of their actionable holdings in the process, a number of the transactions seemed especially hasty since they involved the exercise of options that had strike prices very close to the market price but still had multiple years remaining before any expiration threat.

In the wake of the Faropenem surprise, not only has the risk associated with future revenue streams gone up considerably, but the trading behavior and generally terse disclosure in several related areas leave us wondering what other surprises might be lurking that could serve as additional, significant downside catalysts. As it turns out, there is an interesting array of risk issues out on the horizon, any one of which could exacerbate concerns about the future health of Forest's cash flow once the Company is no longer shielded by patent protection for its three key products.

Fundamentals: Threats to the Lexapro franchise in the near term

Forest's reliance on Lexapro has grown significantly over the past three fiscal years to the point where about two-thirds of current revenue is accounted for by the anti-depressant, so its hard to over state the importance of the drug in the near to intermediate term, while finding a replacement revenue source in the long run when its patents expire becomes all-important. This is why the cancellation of the Replidyne collaboration to develop Faropenem was such an important event.

Figure 2. Lexapro Share of Total Revenue, Fiscal Years 2004-2006. Source: FRX 2006 SEC Form 10-K.



But competition from other manufacturers' drugs and the growing pressure from generics are key fundamental issues even now as the global market for anti-depressants matures further and it will be difficult for the Company to maintain its share of this large market, as it has recently been discovering. Here is an overview of the key competitive threats to Forest's Lexapro franchise:

- **Biovail:** The Canadian pharmaceutical company Biovail has Wellbutrin XL, which is a competitor to Lexapro. Analysts have forecasted declines in Biovail's revenue stream due to the generics coming to market. In 2004, Biovail sued two US pharmaceuticals (Anchen and Abrika) when both tried to file abbreviated drug applications for generic versions of Biovail's Wellbutrin. Wellbutrin XL's patents expire in 2018. On November 14, 2005, Anchen received tentative approval for generic Wellbutrin XL and on August of 2006, The U.S. District Court ruled in favor of Anchen stating that Anchen did not infringe Biovail's patents. On March 5, 2007, Biovail settled the patent infringement case against Anchen, Teva Pharmaceuticals, Impax Laboratories and Watson Pharmaceuticals. The settlement states that "with defined exceptions neither Teva, Anchen, Impax, nor Watson may market a generic version of the 150 mg strength of Wellbutrin XL until 2008. Biovail granted the companies an exclusive license to market a generic version of the 150 mg strength

of Wellbutrin XL for a period of 180 days following market entry. Thereafter, the license becomes nonexclusive."[1] However, Biovail did grant "an exclusive license to Teva, Anchen and Impax to market a generic version of the 300 mg strength of Wellbutrin XL, from December 13, 2006 to June 13, 2007. Thereafter the license becomes nonexclusive."[2] The 150 mg and 300 mg versions had combined sales of $1.8b in 2006 according to Wolters Kluwer Health. Clearly this is a market that everyone would like to be involved in and the key point from the perspective of Forest is that there will be many companies marketing a generic competitor to Lexapro.

- **Caraco:** Caraco submitted an Abbreviated New Drug Application (ANDA) on July 11, 2006 seeking approval to market a generic version of Lexapro. Forest Labs is still currently in litigation with Caraco.

- **Lupin Pharmaceuticals:** Has submitted an ANDA seeking approval to market a generic version of Wyeth's EFFEXOR. EFFEXOR is a competitor to Lexapro. Wyeth is currently in litigation with Lupin.

- **Pliva:** Pliva, a subsidiary of Barr Pharmaceutical, received final approval for its Zoloft generic on February 9, 2007. More competition for Lexapro.

- **Pfizer/Greenstone:** Pfizer's Zoloft patent protection expired on June 30, 2006. Zoloft was Pfizer's third largest drug. Since then Pfizer's subsidiary Greenstone, which markets only Pfizer generics, has introduced a generic form of Zoloft.

After the Zoloft patent expiration, Forest management had been expecting market share expansion for Lexapro. At the beginning of F/Y 2007, they had predicted that Lexapro's market share would grow once Zoloft came off patent protection: ***"****We continue to expect that Lexapro will have a modest market share gain with the increases expected to begin following the launch of generic versions of Zoloft and the expected reduction in promotional activity surrounding that brand."* (Source: Q1 conference call). By Q3 however, it had become evident that the expected growth, between 25 to 50 basis points, had not materialized and that, in fact, it had shrunk some (Source: Q3 conference call). True to form, the Company does not disclose the actual share numbers in conference calls or in any filing.

<u>Fundamentals: Risks facing Forest's all-important drug pipeline</u>

By all indications, Faropenem was ready to be launched in late F/Y 2007 (period ending 03/31/07). The Company had built pre-launch and roll-out expenses into its budget and had been extensively and positively positioning its plans for the anticipated approval of the new drug. Plans were put abruptly on hold when, in late October of last year, the Company announced that it had received a Non-Approvable letter from the FDA and it would have to evaluate its options. With the collaboration with Replidyne just one year old, and with management giving every indication that it would continue its approval efforts in spite of the FDA letter, the sudden February 2007 announcement that Forest was canceling its plans for the drug came as a surprise. This caused some

[1] Genengnews.com. "Biovail Settles Infringement Case Related to Wellbutrin WL", March 5, 2007.
[2] Genengnews.com. "Biovail Settles Infringement Case Related to Wellbutrin WL", March 5, 2007.

analysts to take $300 million off projected 2008 revenues for FRX. We are interested in the differences in disclosures between Forest and Replidyne. Where Replidyne had provided in-depth discussions about its clinical trials, efficacy issues and discussions with the FDA in its recent SEC Form 10-K, Forest seemingly kept most of the problems "under the rug". Indeed, as late as the January 16th conference call, Forest management was giving every indication that it was having "preliminary" discussions with Replidyne regarding any new trial requirements and that it expected to make a final decision by the middle of the year. Yet, it was only three weeks later when Forest pulled the plug.

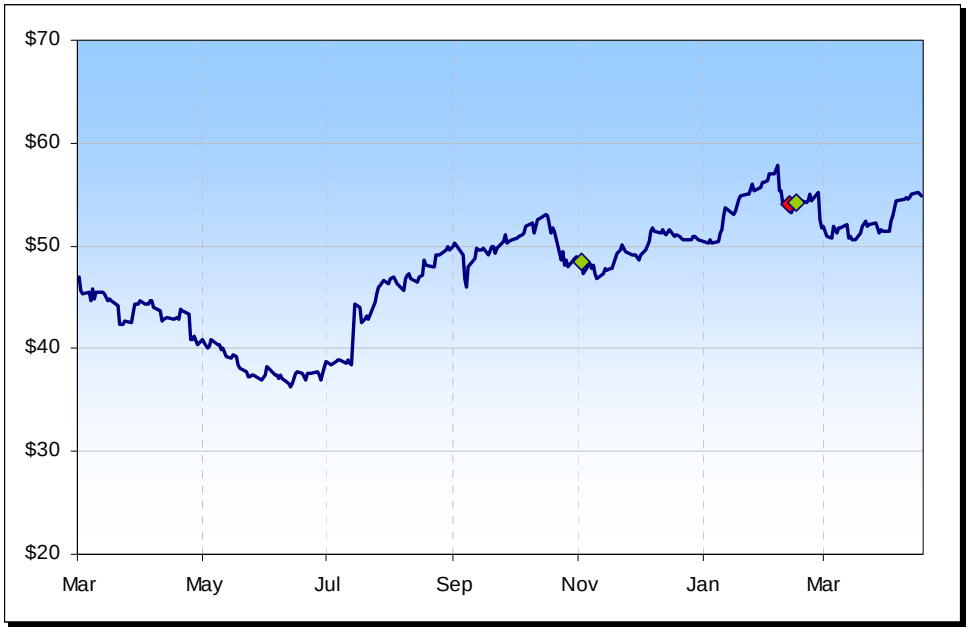
With patents for Lexapro and Namenda (87% of revenues) expiring in the 2012 to 2013 time frame, and the potential for earlier generic challenges to Lexapro, Forest is relying on its current pipeline to pick up the slack of a potential $3 billion sales gap. Though future acquisitions, in order to facilitate this, are not out of the question it is widely known that compelling opportunities for such quick fix transactions at a reasonable price are anything but abundant. This leaves Forest largely dependent on its remaining (after Faropenem) stable of five current pipeline events to come online in the coming year. It seems though, that hitting on all of these could be a stretch. See Appendix A for a summary of the key drugs in Forest's pipeline and some of the challenges facing each of them.

Insider Trading: In haste to get out, insiders skim large blocks of options

Forest Labs first hit our radar back in November of 2006 when former president and chief operating officer Kenneth Goodman surfaced with his largest sale on record, 3 million shares, shortly after announcing that at year-end he would be stepping down from his executive role after serving the Company for 26 years. The move came as a shock to many on the Street as it was widely believed Goodman would run the Company when Chairman, CEO **Howard Solomon** (79) decides to retire. All signs point to this being a voluntary and amicable separation as Goodman plans to remain on the board and "make his wealth of experience and talents available to FRX in that capacity for many years to come", which leaves us to question the motive behind distributing 76% of his ownership. In an interesting twist, it would seem that the board, without issuing any formal disclosure, approved the acceleration of all Goodman's unvested stock options ahead of his scheduled resignation date. He then wasted no time monetizing every last stock option in his possession.

Since the initial disclosure of the Non-Approvable letter concerning Faropenem in late October, and the subsequent onset of heavy insider selling, most of the Section 16 filing executives in the Company surfaced to sell large chunks of their actionable positions. The selling accelerated in late February *after* the news that Forest had ceased its collaboration with Replidyne, essentially eliminating Faropenem from its pipeline. Goodman, who had sold three million shares in November and announced his retirement immediately after the Non-Approvable letter related to the drug, dropped another 300,000 shares after the February 6th Replidyne announcement. This time 200,000 of the 300,000 options he exercised had a strike price of $48.34 and were not set to expire until December of 2012. He sold the underlying shares at $54 for a pre-tax profit of just 11.7%. We have always held that insiders who monetize options close to the market price (skimming) anticipate further price weakness which will effectively put their options at risk of falling out of the money.

Figure 3. FRX Daily Closing Price, 03/01/06 through 04/18/07. Green diamonds are where Director Kenneth Goodman sold shares; Red diamond is where CEO Howard Solomon sold shares. Source: Reuters and FRX SEC Filings.



There were others who "skimmed" their options in their haste to reduce their actionable positions after the Replidyne announcement:

- **Charles Triano (age not disclosed)** – V.P. of Investor Relations. Triano has a limited trading history to analyze over the past seven years, but his one sale, in January 2004, came at the issue's all-time high and just before the stock collapsed 40% over the ensuing two quarters. Now, with the shares trading nearly 30% lower than his last exit date, Triano has sold again, **cashing out 60% of his ownership**. On February 16th he tapped into five separate option series, none of which was set to expire before October 2010, and sold 70,129 shares at $54. A large chunk of the options exercised, 18,000, had the same strike price and expiration date as Goodman's above yielding Triano a slim pre-tax profit of just 11.7%. With just 22,500 options scheduled to become actionable by year-end (see Appendix B), it will take nearly four years before his vested options holdings will be restored.

- **Mary Prehn (age not disclosed)** – V.P. of Licensing. There are a number of disparities between Prehn's February 21st option-related sale which **shed 75% of her ownership** and the twelve previous option transactions executed since 1998. For one, she had never before tapped into more than two option series to sell at one time. Recently, Prehn exercised five series. In addition, 30% of the options she exercised had eight years remaining before expiration and yielded a slim pre-tax profit of just 12%. Never before had Prehn accepted a profit lower than 83% on her options. She will have just 18,000 options become actionable by year-end (see Appendix B).

- **Raymond Stafford (58)** – Executive V.P. of Global Marketing. Stafford is a lesser known officer, last being named in a Proxy back in 1999. Despite his anonymity, he should not be overlooked as he has been with the Company since 1986 and is responsible for all of FRX's global operations. On December 4th Stafford executed his largest sale in the past ten years, monetizing 282,000 options with two years remaining before expiration while also selling 55,000 shares of common stock for a total of 337,000 shares sold, **accounting for 65% of his actionable holdings**. These will not be easily replaced as he has only 30,000 options scheduled to vest over the next two years (see Appendix B).

- **Harold Solomon (79)** – Chairman and CEO. Forest's insider profile became quite intriguing when CEO Solomon unloaded 4.3 million shares into the sell-off that resulted from the news that the Company was terminating its Faropenem partnership. At the time of his February 12th sale, FRX shares were down 10% from the recently-established 52-week highs and showed no signs of reversing course. Solomon's decision to cash out 47% of his total actionable ownership did little to placate investors looking for reassurances that the volatility was only a short-term correction. In fact, Solomon sold more of his ownership in February than he had in any one-year period dating back to 1994. The Company actually took pre-emptive measures to warn the investor community by issuing a press release[3] after the market close two days before the transaction was filed. Included in the release was a personal account of the sale issued by Solomon:

  > **"I have reached an age when it is necessary for me to further an estate plan that properly provides for my family and causes that I support. These share dispositions are being undertaken solely for those purposes. My remaining substantial equity position reflects my commitment to continue to maintain my current active role at Forest and my confidence that Forest's business plan will continue to increase and maximize shareholder value for many years."**

  Estate planning aside, there is little justification for the timing of his sale. We also have to wonder why, if he was so confident in the Company's prospects, he had opted to take the $226 million in cash rather than come up with a more creative plan to pass down FRX shares to his heirs. For instance, had he believed the shares were undervalued after the downturn, one interesting option would have involved depositing the shares into a Grantor Retained Annuity Trust (GRAT) which would have minimized the gift and estate taxes for him and his heirs.

  This is a clear departure from his historical trading behavior as he has routinely sold only when options were nearing expiration. The outright sale of most of his common during the same timeframe when a number of other executives were taking profits makes us unwilling to discount the significance of his sales. Solomon will have 280,000 stock options become actionable primarily in the fourth quarter (see Appendix B).

[3] "Forest Laboratories Announces Rule 144 Sale by Executive Officer", PRNewswire-First Call, February 12, 2007.

And finally, we note that net proceeds from stock options exercised by employees are hitting record levels this fiscal year. This correlates with the high level of Section 16 selling. Through Q3, employee stock options have brought in over $155 million in cash, far above the $62 million at the same time last year. This compares with $79 million during F/Y 2006; $30 million for F/Y 2005 and $68 million in F/Y 2004, the year FRX shares traded in all-time high ground in that year's Q4. Add this to the tax benefit realized from the exercises through Q3 and $208 million, or 22% of the cash generated by FRX through the first three quarters of F/Y 2007 came from employees exercising options in order to sell stock.

Accounting: Benicar seems to be running out of steam, accounting questioned

Benicar, the third product in Forest's three-horse stable, is showing some signs that growth may be slowing. Forest called this "the fastest-growing angiotension receptor blocker" during the Q1 earnings conference call (period ended 06/30/06), contributing pre-tax earnings of $42 million for the quarter (total sales of Benicar were not disclosed). By Q2, the prepared text for the October 17 conference call downplayed the language a bit, saying that Benicar "continues achieving meaningful growth in what remains a very competitive category". Pre-tax earnings for that period came in at $48 million, or 32% of Benicar's total sales of $150 million. By the Q3 call, language again changed: "Regarding Benicar, it continues achieving meaningful growth, especially given its later entry status in a very competitive category". By that period, Benicar's sales had risen to $165 million but its pre-tax earnings contribution to Forest dropped to $39 million, or 24% of sales. Forest explains this in the following way: *The sequential decline in our pre tax earnings contribution from the joint venture despite a sequential increase in end user sales, was due to various expense allocation timing by Daiichi Sankyo which can skew our quarterly contribution from one quarter to the next.* [4]

Fiscal Quarter	Quarter Ended	Revenue	Pre-Tax Earnings	Contribution Margin
Q107	06/30/06	ND*	$42m	ND
Q207	09/30/06	$150m	$48m	32%
Q307	12/31/06	$165m	$39m	24%

*ND = Not disclosed.

Forest claims that the allocations of Benicar-related expenses are out of its control. This very well may be true but we remain curious that during the Q2 conference call, when the Company first adjusted its Benicar-related language (above) it recorded the highest amount of income for the drug for the year. During that same call, however, when asked if Benicar had "lost a little steam" with regards to market share, President Goodman responded in the affirmative, and that the problem was "now behind us" and that they would "reinvigorate our growth in that marketplace". We remain curious about those Benicar-related expense allocations and wonder if anything has changed over

[4] From the Q3 conference call transcript

prior quarters with regards to the reporting of them which may have affected the timing of their recognition.

Accounting: Disclosure of Lexapro/Celexa legal risks may be understated

In addition to the generic and patent infringement cases that FRX has battled and continues to battle, FRX has also been named a defendant in approximately 25 active selective serotonin ruptake inhibitors (SSRIs) related lawsuits. The lawsuits claim "that Celexa or Lexapro caused or contributed to persons committing or attempting suicide."[5] In addition to a risk of suicide, studies have also shown that SSRIs are associated with serious birth defects in babies born to women who used the drugs during pregnancy.

In fact, according to one article, "the company (FRX) is set to be hit with the first Celexa birth defects lawsuit in Kentucky alleging that the company engaged in 'repeated and persistent fraud' by misrepresenting, concealing and otherwise failing to disclose information concerning the safety and effectiveness of Celexa in treating pregnant women." [6] The article goes on to describe the suicidal effects of Celexa in children as well and to detail how Forest potentially manipulated clinical trial study data (subpoenas have been issued for records dating from 1997) in its efforts to seek FDA approval. It is clear from these two articles that this may be just the tip of the iceberg for FRX's legal woes in this area.

The birth defect issue related to SSRIs has thus far gone completely undisclosed by Forest but seems to be gaining some critical mass elsewhere. GlaxoSmithKline discloses in its latest annual report, for example, that it has *"received numerous lawsuits and claims alleging that use of Paxil during the first trimester of pregnancy resulted in the birth of a child with a heart defect or other defect. The Group is also involved in litigation alleging that the use of Paxil during pregnancy resulted in the birth of a baby with primary pulmonary hypertension of the newborn".* [7]

There is a growing trend of warnings issued about SSRIs and birth defects. In late November, the American College of Obstetricians issued a warning which is published as an opinion in the December issue of the journal, Obstetrics & Gynecology. In July of 2006, the FDA issued an advisory warning that infants exposed to SSRIs were six times more likely to develop persistent pulmonary hypertension (PPH), which can be fatal. The list goes on, but Forest has yet to acknowledge that any of this litigation potential represents any legal risk to the Company.

Accounting: Share repurchases halted just before Replidyne announcement

Though the Company does not link the events, it is clear that at the time of the January 16th earnings announcement that Forest had ceased buying shares under its repurchase program. A closer examination of comments issued by management on the

[5] Lawyersandsettlements.com. "Lexapro Legal Problems Mount Against Forest Laboratories", by Evelyn Pringle, November 15, 2006.
[6] OpEdNews.com. "Forest Labs Bogged Down with Celexa Legal Woes", by Evelyn Pringle, October 19, 2006.
[7] GlaxoSmithKline plc, 2006 Annual Report (SEC Form 20-F), filed 03/02/07

Q3 conference call reveals certain confirmation that FRX share valuation may be at its upper limits:

> **Frank Perier (CFO):** With regard to share repurchase, yes, our break even point is right around $50.
>
> **Analyst:** And then lastly, on share repurchases, are you still assuming no additional share repurchases in that fiscal '07 guidance?
>
> **Larry Olanoff (President, COO):** Based upon where we are today, that's a safe assumption.

After repurchasing 7.2 million shares in the fiscal quarter that ended in September and just 1.3 million in the December quarter, it appears likely the Company has not bought back any of the 14 million shares still available under the existing repurchase plan this quarter. So, not only has management divulged that the Company is not willing to pay more than $50 for its shares, but it's actions, with regards to their personal holdings, have also implied that this price range is an opportune exit point as well.

Accounting: Minimal financial disclosure begs questions about earnings quality

Forest's SEC Form 10-Q and 10-K filings are among the shortest and leanest we've ever encountered. Most of the time, we found ourselves relying on conference calls in order to get the granularity required for even simple analysis, and what we can get from earnings releases and their related filings seem quite obfuscated to us. Given what appears to be a lack of candor and general reluctance to release important financial details, combined with other observed behaviors, the potential for earnings management seems apparent to us. For instance, we are always interested when we see a company's fourth quarter net income much lower than previous quarters when, at the same time, revenue and gross profit margins either increase or remain flat. In Forest's case, fourth quarter 2006 sales were the second highest of the four periods for that fiscal year yet net income was less than half of that from any other quarter. Could this be because the auditors came?

In reviewing interim, un-audited financials at Forest we note many things that may suggest earnings management at some level. At times, increased business levels give rise to higher expenses in some major categories and one would expect other expense categories to rise as well. Often, however, it is just the opposite that occurs: Decreases reported in these other expense categories offsetting, in part, the reported increases. It is not uncommon, in Forest's case, to see numerous increases and decreases occurring while earnings per share changes little, when compared to previous periods. Areas drawing our attention in this regard are SG&A expense, R&D expense, tax provisions and changes in total shares outstanding due to stock repurchases. Again, the lack of detail and transparency in the Company's financial reporting leave it open to speculation in these areas.

Governance: Thin and misleading disclosure extends to insider trading

We noticed that prior to the hiring of Chief Counsel **Herschel Weinstein**, in December of 2005, Forest either had no in-house General Counsel or did not require that person to file as an insider under Section 16. A similar exemption seems to have been extended to Chief Medical Officer **Jeffrey Jonas**, who was appointed to the role in 2006 and, on January 22, 2007, defected Forest for Isis Pharmaceuticals. As Chief Medical Officer, Jonas was responsible for Clinical Development, Medical Affairs, Pharmacoviligence and External Scientific Affairs. It is interesting to note that we learned of Jonas's departure only through an Isis press release. Nothing was disclosed from the Forest side; no SEC Form 8-K or press release of any kind was offered. More importantly, however, why was he not required to file as an insider?

When the SEC changed the insider filing rules back in 1991, they broadened the definition of who should file. After the named key executive officers (typically the five highest ranking and compensated executives as listed in the Annual Proxy Statement), those filing should include:

- Any vice president of the issue in charge of a principal business unit, division or function (such as sales, administration or finance)
- Any other officer who performs a significant policy-making function.
- Any other person who performs similar policy-making functions for the issuer.

According to the SEC staff, it is not necessary that a person be an employee of the issuer in order to be considered an officer for filing purposes. Underlying this approach is the presumption that the duties performed by the persons encompassed by the definition are of such importance that they provide these individuals with access to confidential, potentially market-moving information about the issuer.

To this, our eyebrows were raised when Forest did not require that its Chief Medical Officer, responsible for Clinical Development, be included in the definition of a person who must file. The same holds for its Chief Counsel, or person serving in that role, prior to the hiring of Weinstein in 2005. With omissions such as these, one wonders how many other key individuals may have been left out of the picture.

Insider	Position	Ownership Reported	Ownership Actual
Howard Solomon	Chairman, CEO	6,372,743	5,592,548
Ivan Gergel	Senior V.P.	198,750	29,250
Elaine Hochberg	Senior V.P.	701,142	486,142
Raymond Stafford	Executive V.P.	241,040	192,540
Charles Triano	V.P.	119,871	51,371
Mary Prehn	V.P.	59,481	16,481

In addition to questions about why certain key individuals are not filing as Section 16 insiders, we also noticed that when reporting beneficial ownership on each Section 16 filer's Form 4 filings, FRX includes unvested stock options. By definition, unvested options are not considered to be beneficially owned since the holder does not have voting or investment power over the shares. These erroneously inflated ownership figures are misleading to the investor community as it gives the appearance the recent sales accounted for a much smaller percentage of their total actionable holdings. The table above shoes the totals as reported by FRX and the actual holdings figures, after recent sales.

Appendix A

Summary of Key Drugs in
Forest Laboratories Inc.'s Drug Pipeline

- **Nebivolol:** Nebivolol was originally developed by Mylan. In July of 2004 Mylan attempted to acquire King Pharmaceuticals as the distributing sales force but the deal fell through. In mid-2005 Mylan changed its strategy and decided to sell its brand name products and to find a new partner to license Nebivolol. FRX then acquired the U.S. and Canadian marketing rights for an upfront payment of $75m and will make additional royalty payments to Mylan based on sales. Forest will assume all development of the drug and will pay for sales and marketing expenses. Mylan still holds an option to co-promote the drug in the future.[8]

  Originally, FRX was waiting for FDA approval for Nebivolol as a drug for hypertension / high blood pressure, with an anticipated launch date of the first half of 2007. An approvable letter was issued in May of 2005 with final approval dependent upon additional clinical data. However, that market is highly competitive and Mylan decided to also submit a separate application to the FDA for the approval of Nebivolol as a congestive heart failure (CHF) treatment. Although a decision is expected any day, the FDA has not yet made a decision on either application. One successful study with seniors was completed in Europe for CHF and analysts are hoping that an additional study will not be required which would cause further delays. Analysts estimate that the market for Nebivolol as a hypertension drug could be worth $250m to $350m whereas Nebivolol as a CHF treatment could raise peak sales to $600 to $800 million.[9] Nebivolol would compete with GlaxoSmithKline's Coreg, which has nearly a monopoly. Interestingly, Coreg is slated to go generic in early 2007. In the 1Q07 transcript, one analyst seems to indicate that a large degree of skepticism exists over the launch of Nebivolol into an increasingly "genericized" market. Ken Goodman (former COO) responds that FRX believes that they will be able to display substantial product differentiation (pg. 7 of 1Q07 transcript).

  Interestingly, in February of 2006 Mylan received tentative approval for carvedilol, a generic version of Coreg. The approval will be finalized once Coreg's patent expires, which is imminent, and all legal issues are reviewed. Nebivolol seems to be a slightly different beta blocker from carvedilol but not by much. So what does this say about competition – especially coming from Mylan? FRX never mentions the tentative approval that was received by Mylan for carvedilol and if it was something that would work in its favor one would think that it would have been brought up. However, it has not been discussed in any of the conference call transcripts.

  Caraco Pharmaceutical Laboratories Ltd. has also received tentative FDA approval for a generic version of Coreg (also a carvedilol tablet) in January of 2006. Caraco now has approval for particular strengths, 6.25 mg, 12.5 mg and 25 mg.

[8] TheStreet.com. "Mylan, Forest Sign Licensing Deal", by Robert Steyer, January 11, 2006.
[9] WRHambrecht Research Report. "FRX: Nebivolol a nice fit, strengthens pipeline", by Andrew Forman and Wellington Chang, January 12, 2006.

Likewise, the Indian pharmaceutical company Zydus Cadila also received tentative FDA approval for a generic version of Coreg (also a carvedilol tablet) on March 13th of 2006 for four particular strengths, 3.125 mg, 6.25 mg, 12.5 mg and 25 mg. Given that the patent for GlaxoSmithKline's Coreg has officially expired, there seems to be a lot of competition ready and waiting in the wings, while FRX is potentially still waiting for a CHF indication for Nebivolol. FRX does mention that they have built the generics competition into their numbers for Nebivolol, but again, FRX is looking for that Lexapro replacement product and Nebivolol too may not be the blockbuster that they need.

- **Namenda:** Namenda (memantine) is an N-methyl-D-aspartate (NMDA) receptor antagonist for the treatment of moderate to severe Alzheimer's Disease (AD). Namenda accounted for 18.2% of total revenues in fiscal 2006 up from 10.9% and 1.7% in fiscal 2005 and 2004, respectively. In the third quarter of 2007, Namenda accounted for 20% of total revenues. Namenda was first developed by Merz, a private German pharmaceutical company, and a strategic alliance exists among Neurobiological Technologies (NTII) who also had the license, FRX, who markets Namenda in the US and the Danish pharmaceutical Lundbeck, who markets Namenda in Europe. The specific contract details are apparently wrapped in secrecy agreements, but FRX and Lundbeck make royalty and milestone payments to Merz who then in turn shares a small portion (1%) of those royalties and milestones with NTII. FRX began marketing Namenda in 2004 and one can see by the growth in revenue contribution that it has become the second most important drug in FRX's small (essentially three) product portfolio.

  Current treatments, including Namenda, can only temporarily slow the progression of Alzheimer's rather than prevent or treat it. Namenda, used for moderate to severe stages, "protects brain cells from further damage by blocking the release of the neurotransmitter glutamate"[10], but in essence only improves memory, or delays its loss for a short time. As expected, several developments are taking place within the industry that will likely change the way AD is treated over the next ten years. Several promising candidates are in the Phase II and Phase III trial stage with some products anticipated for a 2009 to 2010 product launch. Vaccines are in the Phase I and Phase II stage but with more significant side effects and stem cell therapy continues. FRX has been developing an extension to Namenda, Neramexane, which is claimed to be more selective and to require less frequent dosing than Namenda. However, it is not offering any dramatic new approach to the treatment of AD.[11] Eisai and Pfizer announced on October 17, 2006 that the FDA had approved a supplemental New Drug Application (sNDA) for Aricept, Eisai's inhibitor used in the treatment of the early stages of AD. Aricept is now approved to treat the full spectrum of AD and is the only prescription medication to do so.[12]

  The tracking of the developments within this market is extremely important in that currently FRX's Namenda is one of only three to four pharmaceuticals (and they are usually used in cocktail form) that are available for the treatment of AD. Furthermore, In spite of the fact that Forest's Namenda patent protection expires in

[10] PMLive.com. "Dealing with dementia", by Sarah Harrop, March 8, 2007
[11] PMLive.com. "Dealing with dementia", by Sarah Harrop, March 8, 2007
[12] Medical News Today.com "U.S. Food And Drug Administration Approves ARICEPT® For Treatment Of Severe Alzheimer's Disease, October 17, 2006.

2010 and, by Forest's estimates, should be extendable until 2013, a recent Q2 response to the question as to when the first time generics could file challenges on the drug is interesting. The first time such challenges, or Paragraph IV submissions, could be made would be October of 2007. Given the potential candidates that are in the late stages of clinical trial and their potential impact on the actual treatment of AD, and the additional competition from Eisai's Aricept in the severe AD market, one is left to wonder if Neramexane and potentially Namenda are the winning tickets that Forest is looking for.

➲ **Oglemilast:** Though not part of Forest's imminent pipeline, Oglemilast, or GRRC 3886, being developed by the Company and Glenmark Pharmaceuticals (India), is experiencing problems in its Phase II trials being conducted by Glenmark. Oglemilast is an asthma treatment drug also used for chronic obstructive pulmonary disease. Due to deaths of laboratory animals in the clinical trials, further experiments were halted until further notice. These problems have not only caused Forest to announce in October that it would delay $43 million in milestone payments to Glenmark, originally scheduled for F/Y 2007, to be pushed back "to fiscal 2008". Having said this, Forest has been generally vague as to providing more detail as to approximately when, during the year, those payments are expected to be made.

Glenmark's problems do not end with the Oglemilast trials. The Russian Ministry of Health recently seized 75,000 bottles of Glenmark's Relcer, an antacid drug, after the product failed quality control tests. In addition, contamination had been found as well in other Glenmark products, Ketoplus and Omnicef.[13] The same article goes on to explain that "furthermore it appears that the firm is facing trouble with its partner, Forest Laboratories, with whom it is developing Oglemilast…The process ran into obstacles and created significant tension between the parties, although both are trying to minimize this fact." Indeed, nothing has been said in any of Forest's formal disclosures about any specifics of the situation, except for the delayed milestone payment.

[13] **TMC.net, "Glenmark Pharma finds itself in troubled waters", March 27, 2007.**

Appendix B

Option and Restricted Stock Vesting Schedules for Selected Forest Laboratories, Inc. Insiders

Grant Date	Equity Type	Options/ Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
Howard Solomon, Chairman, CEO. Common stock holdings: 772,548 shares								
12/18/98	Options	600,000	$12.08	12/18/99	12/18/08	600,000	0	Fully Vested
12/17/99	Options	1,200,000	$13.14	12/17/00	12/17/09	1,200,000	0	Fully Vested
12/15/00	Options	2,000,000	$33.45	12/15/01	12/15/10	2,000,000	0	Fully Vested
12/14/01	Options	600,000	$38.14	12/14/02	12/14/11	600,000	0	Fully Vested
12/13/02	Options	400,000	$48.34	12/13/03	12/13/12	400,000	160,000	12/13/07
12/12/03	Options	200,000	$59.05	12/12/04	12/12/13	200,000	110,000	30,000 vest in 12//07; 80,000 vest on 12/08
12/13/04	Options	200,000	$42.53	12/13/05	12/13/14	200,000	140,000	30,000 vest in 12/07 and 12/08; 80,000 vest in 12/09
12/09/05	Options	200,000	$40.29	12/09/06	12/09/15	200,000	170,000	30,000 vest in 12/07, 12/08, and 12/09; 80,000 vest in 12/010
12/08/06	Options	200,000	$51.53	12/08/07	12/08/16	200,000	200,000	30,000 vest in 08/07, 08/08, 08/09, 08/10; 80,000 vest in 08/11
Kenneth Goodman, Director. Common stock holdings: 951,470 shares								
12/12/03	Options	100,000	$59.05	12/12/04	12/12/13	100,000	0	Fully Vested
Ivan Gergel, Senior V.P. of Scientific Affairs. Common stock holdings: 0 shares								
12/13/02	Options	30,000	$48.34	12/13/03	12/13/12	30,000	12,000	12/13/07
12/12/03	Options	15,000	$59.05	12/12/04	12/12/13	15,000	8,250	2,250 vest in 12/07; 6,000 vest in 12/08
12/13/04	Options	15,000	$42.53	12/13/05	12/13/14	15,000	10,500	2,250 vest in 12/07 and 12/08; 6,000 vest in 12/09
08/08/05	Options	75,000	$40.32	08/08/06	08/08/15	63,750	63,750	11,250 vest in 08/07, 08/08, 08/09; 30,000 vest in 08/10
12/08/06	Options	75,000	$51.53	12/08/07	12/08/16	75,000	75,000	11,250 vest in 08/07, 08/08, 08/09, 08/10; 30,000 vest in 08/11
Elaine Hochberg, Senior V.P. of Marketing. Common stock holdings: 89,130 shares								
12/15/00	Options	140,000	$33.45	12/15/01	12/15/10	137,012	0	Fully Vested
12/14/01	Options	150,000	$38.14	12/14/02	12/14/11	150,000	0	Fully Vested
12/13/02	Options	100,000	$48.34	12/13/03	12/13/12	100,000	40,000	12/13/07
12/12/03	Options	50,000	$59.05	12/12/04	12/12/13	50,000	22,500	7,500 vest in 12/07; 20,000 vest in 12/08
12/13/04	Options	50,000	$42.53	12/13/05	12/13/14	50,000	35,000	7,500 vest in 12/13/07 and 12/08; 20,000 vest in 12/09
12/09/05	Options	50,000	$40.29	12/09/06	12/09/15	50,000	42,500	7,500 vest in 12/07, 12/08, and 12/09; 20,000 vest in 12/10
12/08/06	Options	75,000	$51.53	12/08/07	12/08/16	75,000	75,000	11,250 vest in 08/07, 08/08, 08/09, 08/10; 30,000 vest in 08/11
Mary Prehn, V.P. of Licensing. Common stock holdings: 11,981 shares								
12/13/02	Options	30,000	$48.34	12/13/03	12/13/12	12,000	12,000	12/13/07
12/12/03	Options	10,000	$59.05	12/12/04	12/12/13	10,000	5,500	1,500 vest in 12/07; 4,000 vest in 12/08
12/13/04	Options	10,000	$42.53	12/13/05	12/13/14	7,000	7,000	1,500 vest in 12/13/07 and 12/08; 4,000 vest in 12/09
12/09/05	Options	10,000	$40.29	12/09/06	12/09/15	8,500	8,500	1,500 vest in 12/07, 12/08, and 12/09; 4,000 vest in 12/10
12/08/06	Options	10,000	$51.53	12/08/07	12/08/16	10,000	10,000	1,500 vest in 08/07, 08/08, 08/09, 08/10; 4,000 vest in 08/11

Appendix B

Option and Restricted Stock Vesting Schedules for Selected Forest Laboratories, Inc. Insiders

Grant Date	Equity Type	Options/ Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
Raymond Stafford, Executive V.P. of Global Marketing. Common stock holdings: 101,040 shares								
12/14/01	Options	150,000	$38.14	12/14/02	12/14/11	60,000	0	Fully Vested
12/13/02	Options	30,000	$48.34	12/13/03	12/13/12	30,000	12,000	12/13/07
12/12/03	Options	15,000	$59.05	12/12/04	12/12/13	15,000	8,250	2,250 vest in 12/07; 6,000 vest in 12/08
12/13/04	Options	15,000	$42.53	12/13/05	12/13/14	15,000	10,500	2,250 vest in 12/07 and 12/08; 6,000 vest in 12/09
12/09/05	Options	15,000	$40.29	12/09/06	12/09/15	15,000	12,750	2,250 vest in 12/07, 12/08, and 12/09; 6,000 vest in 12/10
12/08/06	Options	25,000	$51.53	12/08/07	12/08/16	25,000	25,000	2,250 vest in 08/07, 08/08, 08/09, 08/10; 6,000 vest in 08/11
Charles Triano, V.P. of Investor Relations. Common stock holdings: 0 shares								
10/30/00	Options	100,000	$32.92	10/30/01	10/30/10	52,000	0	Fully Vested
12/13/02	Options	30,000	$48.34	12/13/03	12/13/12	12,000	12,000	12/13/07
12/12/03	Options	15,000	$59.05	12/12/04	12/12/13	15,000	8,250	2,250 vest in 12/07; 6,000 vest in 12/08
12/13/04	Options	15,000	$42.53	12/13/05	12/13/14	10,501	10,500	2,250 vest in 12/13/07 and 12/08; 6,000 vest in 12/09
12/09/05	Options	15,000	$40.29	12/09/06	12/09/15	12,750	12,750	2,250 vest in 12/07, 12/08, and 12/09; 6,000 vest in 12/010
12/08/06	Options	25,000	$51.53	12/08/07	12/08/16	25,000	25,000	3,750 vest in 08/07, 08/08, 08/09, 08/10; 10,000 vest in 08/11