MEDICIS PHARMACEUTICAL CORP
Form 10-Q
August 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number 0-18443

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	52-1574808
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8125 North Hayden Road
Scottsdale, Arizona 85258-2463
(Address of principal executive offices)
(602) 808-8800
(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2) YES o NO þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Class	Shares Outstanding at August 3, 2007
Class A Common Stock $.014 Par Value	56,115,791

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Part I. Financial Information
Item 1. Financial Statements

MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	June 30, 2007 (unaudited)	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 62,015	$ 203,319
Short-term investments	534,500	350,942
Accounts receivable, net		36,370
Inventories, net	30,657	27,016
Deferred tax assets, net	22,940	23,047
Other current assets	19,166	15,990
Total current assets	669,278	656,684
Property and equipment, net	9,618	6,576
Intangible assets:		
Intangible assets related to product line acquisitions and business combinations	260,773	239,396
Other intangible assets	6,632	6,052
	267,405	245,448
Less: accumulated amortization	81,628	76,241
Net intangible assets	185,777	169,207
Goodwill	63,107	63,107
Deferred tax assets, net	34,356	41,241
Long-term investments	148,395	130,290
Deferred financing costs, net	1,198	2,181
	$ 1,111,729	$ 1,069,286

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	June 30, 2007 (unaudited)	December 31, 2006
Liabilities		
Current liabilities:		
Accounts payable	$ 40,514	$ 47,513
Income taxes payable	430	11,346
Other current liabilities	57,621	47,803
Total current liabilities	98,565	106,662
Long-term liabilities:		
Contingent convertible senior notes	453,060	453,065
Other liabilities	543	
Stockholders Equity		
Preferred stock, $0.01 par value; shares authorized: 5,000,000; no shares issued		
Class A common stock, $0.014 par value; shares authorized: 150,000,000; issued and outstanding: 68,744,878 and 68,044,363 at June 30, 2007 and December 31, 2006, respectively	962	952
Class B common stock, $0.014 par value; shares authorized: 1,000,000; no shares issued		
Additional paid-in capital	627,728	598,435
Accumulated other comprehensive income	734	537
Accumulated earnings	273,041	252,431
Less: Treasury stock, 12,653,043 and 12,650,233 shares at cost at June 30, 2007 and December 31, 2006, respectively	(342,904)	(342,796)
Total stockholders equity	559,561	509,559
	$ 1,111,729	$ 1,069,286

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net product revenues	$ 105,902	$ 80,646	$ 198,273	$ 151,733
Net contract revenues	2,962	4,386	5,705	8,456
Net revenues	108,864	85,032	203,978	160,189
Cost of product revenues (1)	14,011	9,419	24,508	21,598
Gross profit	94,853	75,613	179,470	138,591
Operating expenses:				
Selling, general and administrative (2)	59,894	51,065	122,155	102,288
Impairment of long-lived assets	4,067		4,067	
Research and development (3)	7,148	43,767	15,154	140,985
Depreciation and amortization	5,878	5,800	11,332	11,656
Operating income (loss)	17,866	(25,019)	26,762	(116,338)
Interest and investment income	9,251	7,262	18,258	14,283
Interest expense	(2,568)	(2,658)	(5,226)	(5,316)
Income (loss) before income tax expense	24,549	(20,415)	39,794	(107,371)
Income tax expense (benefit)	9,026	(35,934)	14,983	(34,347)
Net income (loss)	$ 15,523	$ 15,519	$ 24,811	$ (73,024)
Basic net income (loss) per share	$ 0.28	$ 0.28	$ 0.44	$ (1.34)
Diluted net income (loss) per share	$ 0.24	$ 0.25	$ 0.39	$ (1.34)
Cash dividend declared per common share	$ 0.03	$ 0.03	$ 0.06	$ 0.06

Basic common shares outstanding	55,936	54,501	55,782	54,429
Diluted common shares outstanding	71,318	69,733	71,466	54,429

(1) amounts exclude amortization of intangible assets related to acquired products	$ 5,165	$ 5,075	$ 9,963	$ 10,150
(2) amounts include share-based compensation expense	$ 5,524	$ 6,835	$ 10,900	$ 13,482
(3) amounts include share-based compensation expense	$ 117	$ 505	$ 255	$ 1,038

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Six Months Ended	
	June 30, 2007	June 30, 2006
Operating Activities:		
Net income (loss)	$ 24,811	$ (73,024)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,332	11,656
Amortization of deferred financing fees	982	1,072
Impairment of long-lived assets	4,067	
Loss on disposal of property and equipment	19	9
Gain on sale of available-for-sale investments	(48)	(227)
Share-based compensation expense	11,156	14,521
Deferred income tax expense (benefit)	6,992	(40,402)
Tax benefit from exercise of stock options and vesting of restricted stock awards	2,387	1,039
Excess tax benefits from share-based payment arrangements	(1,215)	(563)
(Decrease) increase in provision for doubtful accounts and returns	(8,564)	1,618
Amortization of (discount)/premium on investments	(1,457)	(1,452)
Changes in operating assets and liabilities:		
Accounts receivable	54,227	(3,247)
Inventories	(3,641)	(25)
Other current assets	(3,176)	(2,138)
Accounts payable	(6,999)	2,784
Income taxes payable	(11,724)	(21,723)
Other current liabilities	(612)	9,657
Other liabilities	543	
Net cash provided by (used in) operating activities	79,080	(100,445)
Investing Activities:		
Purchase of property and equipment	(4,330)	(723)
Payment of direct merger costs		(27,420)
Payments for purchase of product rights	(29,700)	(588)
Purchase of available-for-sale investments	(446,542)	(388,865)
Sale of available-for-sale investments	114,889	169,123
Maturity of available-for-sale investments	131,283	121,620
Net cash used in investing activities	(234,400)	(126,853)
Financing Activities:		
Payment of dividends	(3,363)	(3,278)
Excess tax benefits from share-based payment arrangements	1,215	563
Proceeds from the exercise of stock options	15,754	5,948

Net cash provided by financing activities	13,606	3,233
Effect of exchange rate on cash and cash equivalents	410	139
Net decrease in cash and cash equivalents	(141,304)	(223,926)
Cash and cash equivalents at beginning of period	203,319	446,997
Cash and cash equivalents at end of period	$ 62,015	$ 223,071

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2007
(unaudited)

1. NATURE OF BUSINESS

Medicis Pharmaceutical Corporation (Medicis or the Company) is a leading specialty pharmaceutical company focusing primarily on the development and marketing of products in the United States (U.S.) for the treatment of dermatological, aesthetic and podiatric conditions. Medicis also markets products in Canada for the treatment of dermatological and aesthetic conditions.

The Company offers a broad range of products addressing various conditions or aesthetic improvements including facial wrinkles, acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, skin and skin-structure infections, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 18 branded products. Its primary brands are PERLANE®, RESTYLANE®, SOLODYN®, TRIAZ®, VANOS and ZIANA.

The consolidated financial statements include the accounts of Medicis and its wholly owned subsidiaries. The Company does not have any subsidiaries in which it does not own 100% of the outstanding stock. All of the Company s subsidiaries are included in the consolidated financial statements. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying interim condensed consolidated financial statements of Medicis have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. The financial information is unaudited, but reflects all adjustments, consisting only of normal recurring accruals, which are, in the opinion of the Company s management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

2. SHARE-BASED COMPENSATION

At June 30, 2007, the Company had seven active share-based employee compensation plans. Of these seven share-based compensation plans, only the 2006 Incentive Award Plan is eligible for the granting of future awards. At the Company s 2007 Annual Meeting of Stockholders held on May 22, 2007, the stockholders of the Company approved an amendment to the 2006 Incentive Award Plan, increasing the number of shares of common stock reserved for issuance under the plan by 2,500,000 shares. Stock option awards granted from these plans are granted at the fair market value on the date of grant. The option awards vest over a period determined at the time the options are granted, ranging from one to five years, and generally have a maximum term of ten years. Certain options provide for accelerated vesting if there is a change in control (as defined in the plans). When options are exercised, new shares of the Company s Class A common stock are issued. Effective July 1, 2005, the Company adopted SFAS No. 123R using the modified prospective method. Other than restricted stock, no share-based employee compensation cost has been reflected in net income prior to the adoption of SFAS No. 123R.

The adoption of SFAS No. 123R decreased income before income tax expense for the three months and six months ended June 30, 2007 by approximately $5.6 million and $11.2 million, respectively, and decreased net income for the three months and six months ended June 30, 2007 by approximately $3.3 million and $7.0 million, respectively. As a result, basic and diluted net income per common share for the three months ended June 30, 2007 were reduced $0.06 and $0.05, respectively, and basic and diluted net income per common share for the six months ended June 30, 2007 were reduced $0.12 and $0.10, respectively.

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The total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of June 30, 2007, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to June 30, 2007, was approximately $26.8 million and the related weighted-average period over which it is expected to be recognized is approximately 1.9 years.

Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the condensed consolidated statements of cash flows. SFAS No. 123R requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. Approximately $0.4 million and $1.2 million of excess tax benefits were recognized during the three months and six months ended June 30, 2007, respectively.

A summary of stock options activity within the Company s stock-based compensation plans and changes for the six months ended June 30, 2007 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2006	12,989,011	$27.63		
Granted	119,553	$33.75		
Exercised	(656,128)	$21.21		
Terminated/expired	(154,377)	$32.71		
Balance at June 30, 2007	12,298,059	$27.97	5.18	$53,169,394

The intrinsic value of options exercised during the six months ended June 30, 2007 was $8,488,467. Options exercisable under the Company s share-based compensation plans at June 30, 2007 were 8,045,524, with an average exercise price of $25.82, an average remaining contractual term of 4.5 years, and an aggregate intrinsic value of $44,569,348.

A summary of fully vested stock options and stock options expected to vest, based on historical forfeiture rates, as of June 30, 2007, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding	11,892,468	$27.95	5.2	$51,627,968
Exercisable	7,820,172	$25.81	4.5	$43,424,843

The fair value of each stock option award is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Expected dividend yield	0.4%	0.4%
Expected stock price volatility	0.35	0.36
Risk-free interest rate	4.5% to 4.8%	4.5%

Expected life of options	7 Years	7 Years

The expected dividend yield is based on expected annual dividends to be paid by the Company as a percentage of the market value of the Company s stock as of the date of grant. The Company determined that a blend of implied volatility and historical volatility is more reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The risk-free interest rate is based on the U.S.

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treasury security rate in effect as of the date of grant. The expected lives of options are based on historical data of the Company.

The weighted average fair value of stock options granted during the six months ended June 30, 2007 and 2006 was $14.98 and $13.36, respectively.

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company s Class A common stock on the date of grant, and the total value of the award is expensed ratably over the service period of the employees receiving the grants. During the six months ended June 30, 2007, 334,179 shares of restricted stock were granted to certain employees. Share-based compensation expense related to all restricted stock awards outstanding during the three months and six months ended June 30, 2007, was approximately $1.1 million and $1.7 million, respectively. Share-based compensation expense related to all restricted stock awards outstanding during the three months and six months ended June 30, 2006, was approximately $0.6 million and $1.0 million, respectively. As of June 30, 2007, the total amount of unrecognized compensation cost related to non-vested restricted stock awards, to be recognized as expense subsequent to June 30, 2007, was approximately $16.3 million, and the related weighted-average period over which it is expected to be recognized is approximately 4.2 years.

A summary of restricted stock activity within the Company s share-based compensation plans and changes for the six months ended June 30, 2007 is as follows:

Non-vested Shares	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at December 31, 2006	295,579	$29.98
Granted	334,179	$33.39
Vested	(17,966)	$29.37
Forfeited	(5,862)	$32.20
Non-vested at June 30, 2007	605,930	$31.86

The total fair value of restricted shares vested during the six months ended June 30, 2007 and the six months ended June 30, 2006 was approximately $0.5 million and $0.1 million, respectively.

3. RESEARCH AND DEVELOPMENT COSTS AND ACCOUNTING FOR STRATEGIC COLLABORATIONS

All research and development costs, including payments related to products under development and research consulting agreements, are expensed as incurred. The Company may continue to make non-refundable payments to third parties for new technologies and for research and development work that has been completed. These payments may be expensed at the time of payment depending on the nature of the payment made.

The Company s policy on accounting for costs of strategic collaborations determines the timing of the recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or capitalized as an asset. Management is required to form judgments with respect to the commercial status of such products in determining whether development costs meet the criteria for immediate expense or capitalization. For example, when the Company acquires certain products for which there is already an Abbreviated New Drug Application (ANDA) or a New Drug Application (NDA) approval related directly to the product, and there is net realizable value based on projected sales for these products, the Company capitalizes the amount paid as an intangible asset. If the Company acquires product rights that are in the development phase and as to which the Company has no assurance that the third party will successfully complete its developmental milestones, the Company expenses such

payments.

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During 2003, the Company entered into numerous agreements with Q-Med AB (Q-Med), a Swedish biotechnology/medical device company, for the rights to market, distribute and commercialize the dermal restorative product lines known as RESTYLANE®, PERLANE® and RESTYLANE FINE LINES™. Under terms of the agreements, the Company was to pay Q-Med milestone payments for the achievement of certain specific development and commercial milestones. On May 2, 2007, the FDA approved PERLANE® for implantation into the deep dermis to superficial subcutis for the correction of moderate to severe facial folds and wrinkles, such as nasolabial folds. In accordance with the Company s agreements with Q-Med, the Company paid $29.1 million to Q-Med during the three months ended June 30, 2007 as a result of this milestone. The $29.1 million payment is included in long-lived assets in the Company s condensed consolidated balance sheets as of June 30, 2007, and is being amortized over its useful life.

During 2002, the Company entered into an exclusive license and development agreement with Dow Pharmaceutical Sciences, Inc. (Dow) for the development and commercialization of a patented dermatologic product. The product, ZIANA™, was approved by the FDA during the three months ended December 31, 2006. The license and development agreement included a one-time milestone payment of $1.0 million payable to Dow the first time the product achieved a specific commercialization milestone during a 12-month period ending on the anniversary of the product s launch date. This milestone was achieved during the three months ended June 30, 2007, and the $1.0 million milestone payment was accrued for as of June 30, 2007, and was recorded as an addition to long-lived assets in the Company s condensed consolidated balance sheets. In accordance with the agreement, the milestone is payable during the three months ended March 31, 2008.

4. DEVELOPMENT AND DISTRIBUTION AGREEMENT WITH IPSEN FOR RIGHTS TO IPSEN S BOTULINUM TOXIN TYPE A PRODUCT KNOWN AS RELOXIN®

On March 17, 2006, the Company entered into a development and distribution agreement with Ipsen Ltd., a wholly-owned subsidiary of Ipsen S.A. (Ipsen), whereby Ipsen granted Aesthetica Ltd., a wholly-owned subsidiary of Medicis, rights to develop, distribute and commercialize Ipsen s botulinum toxin type A product in the United States, Canada and Japan for aesthetic use by physicians. The product is commonly referred to as RELOXIN® in the U.S. aesthetic market and DYSPORT® in medical and aesthetic markets outside the U.S. The product is not currently approved for use in the U.S., Canada or Japan. Medicis made an initial payment to Ipsen in the amount of $90.1 million in consideration for the exclusive distribution rights in the U.S., Canada and Japan.

Additionally, Medicis and Ipsen agreed to negotiate and enter into an agreement relating to the exclusive distribution and development rights of the product for the aesthetic market in Europe, and subsequently in certain other markets. Under the terms of the U.S., Canada and Japan agreement, as amended, Medicis was obligated to make an additional $35.1 million payment to Ipsen if this agreement was not entered into by April 15, 2006. On April 13, 2006, Medicis and Ipsen agreed to extend this deadline to July 15, 2006. In connection with this extension, Medicis paid Ipsen approximately $12.9 million in April 2006, which would be applied against the total obligation, in the event an agreement was not entered into by the extended deadline. On July 17, 2006, Medicis and Ipsen agreed that the two companies would not pursue an agreement for the commercialization of the product outside of the U.S., Canada and Japan. On July 17, 2006, Medicis made the additional $22.2 million payment to Ipsen, representing the remaining portion of the $35.1 million total obligation, resulting from the discontinuance of negotiations for other territories.

The initial $90.1 million payment was recognized as a charge to research and development expense during the three months ended March 31, 2006, and the $35.1 million obligation was recognized as a charge to research and development expense during the three months ended June 30, 2006.

Medicis will pay an additional $26.5 million upon successful completion of various clinical and regulatory milestones, $75.0 million upon the product s approval by the FDA and $2.0 million upon regulatory approval of the product in Japan. Ipsen will manufacture and provide the product to Medicis for the term of the agreement, which extends to December 2036. Ipsen will receive a royalty based on sales and a supply price, the total of which is equivalent to approximately 30% of net sales as defined under the

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agreement. Under the terms of the agreement, Medicis is responsible for all remaining research and development costs associated with obtaining the product s approval in the U.S., Canada and Japan.

5. IMPAIRMENT OF LONG-LIVED ASSETS

The Company assesses the potential impairment of long-lived assets on a periodic basis and when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Factors that the Company considers in deciding when to perform an impairment review include significant under-performance of a product line in relation to expectations, significant negative industry or economic trends, and significant changes or planned changes in the Company s use of the assets. Recoverability of assets that will continue to be used in the Company s operations is measured by comparing the carrying amount of the asset grouping to the Company s estimate of the related total future net cash flows. If an asset carrying value is not recoverable through the related cash flows, the asset is considered to be impaired. The impairment is measured by the difference between the asset grouping s carrying amount and its fair value, based on the best information available, including market prices or discounted cash flow analysis. If the assets determined to be impaired are to be held and used, the Company recognizes an impairment loss through a charge to operating results to the extent the present value of anticipated net cash flows attributable to the asset are less than the asset s carrying value. When it is determined that the useful life of assets are shorter than originally estimated, and there are sufficient cash flows to support the carrying value of the assets, the Company will accelerate the rate of amortization charges in order to fully amortize the assets over their new shorter useful lives.

During th