

MEDICIS PHARMACEUTICAL CORP

Form 10-Q

May 10, 2010

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

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

For the quarterly period ended March 31, 2010

OR

**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: 001-14471

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.)

7720 North Dobson Road
Scottsdale, Arizona 85256-2740
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(do not check if a smaller
reporting company)

Smaller reporting
company

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2) Yes No
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class
Class A Common Stock \$.014 Par Value

Outstanding at May 5, 2010
60,284,069 (a)

- (a) includes
2,036,491
shares of
unvested
restricted stock
awards
-

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MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	March 31, 2010	December 31, 2009
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 103,843	\$ 209,051
Short-term investments	454,622	319,229
Accounts receivable, net	109,950	95,222
Inventories, net	29,387	25,985
Deferred tax assets, net	66,574	66,321
Other current assets	19,776	16,525
Total current assets	784,152	732,333
Property and equipment, net	25,568	25,247
Net intangible assets	222,151	227,840
Goodwill	93,282	93,282
Deferred tax assets, net	58,454	64,947
Long-term investments	29,974	25,524
Other assets	3,025	3,025
	\$ 1,216,606	\$ 1,172,198

See accompanying notes to condensed consolidated financial statements.

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

	March 31, 2010	December 31, 2009
	(unaudited)	
Liabilities		
Current liabilities:		
Accounts payable	\$ 47,698	\$ 44,183
Reserve for sales returns	43,716	48,062
Accrued consumer rebates and loyalty programs	94,582	73,311
Managed care and Medicaid reserves	48,964	47,078
Income taxes payable	15,824	16,679
Other current liabilities	59,186	68,381
Total current liabilities	309,970	297,694
Long-term liabilities:		
Contingent convertible senior notes	169,326	169,326
Other liabilities	8,921	9,919
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: 71,073,076 and 70,732,409 at March 31, 2010 and December 31, 2009, respectively	986	985
Class B common stock, \$0.014 par value; shares authorized: 1,000,000; issued and outstanding: none		
Additional paid-in capital	693,801	690,497
Accumulated other comprehensive loss	(3,249)	(3,814)
Accumulated earnings	383,600	351,842
Less: Treasury stock, 12,859,425 and 12,749,261 shares at cost at March 31, 2010 and December 31, 2009, respectively	(346,749)	(344,251)
Total stockholders equity	728,389	695,259
	\$ 1,216,606	\$ 1,172,198

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	
	March 31, 2010	March 31, 2009
Net product revenues	\$ 164,541	\$ 96,600
Net contract revenues	1,950	3,219
Net revenues	166,491	99,819
Cost of product revenues (1)	15,757	9,446
Gross profit	150,734	90,373
Operating expenses:		
Selling, general and administrative (2)	75,948	70,425
Research and development (3)	10,164	13,275
Depreciation and amortization	7,053	7,132
Operating income (loss)	57,569	(459)
Interest and investment income	(1,160)	(2,487)
Interest expense	1,058	1,054
Other expense, net	258	2,873
Income (loss) before income tax expense	57,413	(1,899)
Income tax expense (benefit)	22,042	(2,228)
Net income	\$ 35,371	\$ 329
Basic net income per share	\$ 0.59	\$ 0.01
Diluted net income per share	\$ 0.54	\$ 0.01
Cash dividend declared per common share	\$ 0.06	\$ 0.04

Common shares used in calculating:		
Basic net income per share	58,049	56,731
Diluted net income per share	64,192	56,867

(1) amounts exclude amortization of intangible assets related to acquired products	\$ 5,351	\$ 5,443
(2) amounts include share-based compensation expense	\$ 2,963	\$ 3,733
(3) amounts include share-based compensation expense	\$ 132	\$ 139

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	March 31, 2010	March 31, 2009
Operating Activities:		
Net income	\$ 35,371	\$ 329
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,053	7,132
Adjustment of impairment of available-for-sale investments	260	(13)
Charge reducing value of investment in Revance		2,886
Loss (gain) on sale of available-for-sale investments, net	34	(10)
Share-based compensation expense	3,095	3,872
Deferred income tax benefit	6,011	(10,680)
Tax expense from exercise of stock options and vesting of restricted stock awards	47	(644)
Excess tax benefits from share-based payment arrangements	(287)	
Increase in provision for sales discounts and chargebacks	666	144
Accretion (amortization) of premium/(discount) on investments	826	516
Changes in operating assets and liabilities:		
Accounts receivable	(15,394)	1,531
Inventories	(3,401)	(1,125)
Other current assets	(3,253)	(1,203)
Accounts payable	3,515	4,720
Reserve for sales returns	(4,346)	8,795
Income taxes payable	(855)	4,440
Other current liabilities	9,553	26,016
Other liabilities	(998)	(1,308)
Net cash provided by operating activities	37,897	45,398
Investing Activities:		
Purchase of property and equipment	(1,958)	(1,875)
Payments for purchase of product rights	273	(161)
Purchase of available-for-sale investments	(207,326)	(74,264)
Sale of available-for-sale investments	12,782	30,494
Maturity of available-for-sale investments	54,215	55,029
Net cash (used in) provided by investing activities	(142,014)	9,223
Financing Activities:		
Payment of dividends	(2,389)	(2,313)
Excess tax benefits from share-based payment arrangements	287	
Proceeds from the exercise of stock options	850	

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Net cash used in financing activities	(1,252)	(2,313)
Effect of exchange rate on cash and cash equivalents	161	74
Net (decrease) increase in cash and cash equivalents	(105,208)	52,382
Cash and cash equivalents at beginning of period	209,051	86,450
Cash and cash equivalents at end of period	\$ 103,843	\$ 138,832

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2010
(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 and aesthetic conditions. Medicis also markets products in Canada for the treatment of dermatological and aesthetic conditions and began commercial efforts in Europe with the Company s acquisition of LipoSonix, Inc. (LipoSonix) in July 2008.

The Company offers a broad range of products addressing various conditions or aesthetic improvements including facial wrinkles, glabellar lines, acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 17 branded products. Its primary brands are DYSPORT , PERLANE®, RESTYLANE®, SOLODYN®, TRIAZ®, VANOS® and ZIANA®. Medicis entered the non-invasive body contouring market with its acquisition of LipoSonix in July 2008.

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, 2009. The financial information is unaudited, but reflects all adjustments, consisting only of normal recurring adjustments and 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, 2009.

2. SHARE-BASED COMPENSATION

Stock Option and Restricted Stock Awards

At March 31, 2010, 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. 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.

The total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of March 31, 2010, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to March 31, 2010, was approximately \$1.4 million and the related weighted average period over which it is expected to be recognized is approximately 2.6 years.

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A summary of stock option activity within the Company's stock-based compensation plans and changes for the three months ended March 31, 2010, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2009	9,253,847	\$ 29.24		
Granted	48,295	\$ 22.69		
Exercised	(45,577)	\$ 18.67		
Terminated/expired	(117,565)	\$ 29.31		
Balance at March 31, 2010	9,139,000	\$ 29.26	2.8	\$ 8,488,913

The intrinsic value of options exercised during the three months ended March 31, 2010, was \$282,612. Options exercisable under the Company's share-based compensation plans at March 31, 2010, were 8,793,300, with a weighted average exercise price of \$29.54, a weighted average remaining contractual term of 2.6 years, and an aggregate intrinsic value of \$6,515,204.

A summary of outstanding and exercisable stock options that are fully vested and are expected to vest, based on historical forfeiture rates, as of March 31, 2010, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, net of expected forfeitures	8,357,777	\$ 29.38	2.8	\$ 7,534,338
Exercisable, net of expected forfeitures	8,059,055	\$ 29.65	2.7	\$ 5,820,722

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:

	Three Months Ended	
	March 31, 2010	March 31, 2009
Expected dividend yield	1.06%	0.35%
Expected stock price volatility	0.33	0.45
Risk-free interest rate	3.04%	2.20%
Expected life of options	7.0 Years	7.0 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. 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 three months ended March 31, 2010 and 2009, was \$8.10 and \$5.32, respectively.

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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 three months ended March 31, 2010, 511,235 shares of restricted stock were granted to certain employees. Share-based compensation expense related to all restricted stock awards outstanding during the three months ended March 31, 2010 and 2009, was approximately \$1.9 million and \$1.8 million, respectively. As of March 31, 2010, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to March 31, 2010, was approximately \$33.0 million, and the related weighted average period over which it is expected to be recognized is approximately 3.3 years.

A summary of restricted stock activity within the Company's share-based compensation plans and changes for the three months ended March 31, 2010, is as follows:

Nonvested Shares	Shares	Weighted Average Grant-Date Fair Value
Nonvested at December 31, 2009	1,915,469	\$ 17.12
Granted	511,235	\$ 22.69
Vested	(295,090)	\$ 18.26
Forfeited	(31,717)	\$ 23.59
Nonvested at March 31, 2010	2,099,897	\$ 18.22

The total fair value of restricted shares vested during the three months ended March 31, 2010 and 2009, was approximately \$5.4 million and \$2.6 million, respectively.

Stock Appreciation Rights

During 2009, the Company began granting cash-settled stock appreciation rights (SARs) to many of its employees. SARs generally vest over a graduated five-year period and expire seven years from the date of grant, unless such expiration occurs sooner due to the employee's termination of employment, as provided in the applicable SAR award agreement. SARs allow the holder to receive cash (less applicable tax withholding) upon the holder's exercise, equal to the excess, if any, of the market price of the Company's Class A common stock on the exercise date over the exercise price, multiplied by the number of shares relating to the SAR with respect to which the SAR is exercised. The exercise price of the SAR is the fair market value of a share of the Company's Class A common stock relating to the SAR on the date of grant. The total value of the SARs is expensed over the service period of the employees receiving the grants, and a liability is recognized in the Company's condensed consolidated balance sheets until settled. The fair value of SARs is required to be remeasured at the end of each reporting period until the award is settled, and changes in fair value must be recognized as compensation expense to the extent of vesting each reporting period based on the new fair value. Share-based compensation expense related to SARs during the three months ended March 31, 2010 and 2009, was approximately \$0.7 million and \$0.2 million, respectively. As of March 31, 2010, the total measured amount of unrecognized compensation cost related to outstanding SARs, to be recognized as expense subsequent to March 31, 2010, was approximately \$33.5 million, and the related weighted average period over which it is expected to be recognized is approximately 4.4 years.

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The fair value of each SAR was estimated on the date of the grant, and was remeasured at quarter-end, using the Black-Scholes option pricing model with the following assumptions:

	SARs Granted During Three Months Ended March 31, 2010	SARs Granted During Three Months Ended March 31, 2009	Remeasurement as of March 31, 2010
Expected dividend yield	1.06%	0.35%	0.95%
Expected stock price volatility	0.33	0.45	0.32
Risk-free interest rate	3.04%	2.20%	3.28%
Expected life of SARs	7.0 Years	7.0 Years	6.4 Years

The weighted average fair value of SARs granted during the three months ended March 31, 2010 and 2009, as of the respective grant dates, was \$8.10 and \$5.32, respectively. The weighted average fair value of all SARs outstanding as of the remeasurement date of March 31, 2010 was \$12.80.

A summary of SARs activity for the three months ended March 31, 2010, is as follows:

	Number of SARs	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2009	1,916,156	\$ 11.40		
Granted	1,333,176	\$ 22.69		
Exercised	(13,359)	\$ 11.38		
Terminated/expired	(152,857)	\$ 12.06		
Balance at March 31, 2010	3,083,116	\$ 16.25	6.4	\$ 27,477,110

As of March 31, 2010, 174,044 SARs were exercisable, with a weighted average exercise price of \$11.29, a weighted average remaining contractual term of 5.9 years, and an aggregate intrinsic value of \$2,413,230.

3. SHORT-TERM AND LONG-TERM INVESTMENTS

The Company's policy for its short-term and long-term investments is to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company's investment guidelines and market conditions. Short-term and long-term investments consist of corporate and various government agency and municipal debt securities. The Company's investments in auction rate floating securities consist of investments in student loans. Management classifies the Company's short-term and long-term investments as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses reported in stockholders' equity. Realized gains and losses and declines in value judged to be other than temporary, if any, are included in other expense in the condensed consolidated statement of operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary, results in impairment of the fair value of the investment. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security. Dividends and interest income are recognized when earned. The cost of securities sold is

calculated using the specific identification method. At March 31, 2010, the Company has recorded the estimated fair value of available-for-sale and trading securities in short-term and long-term investments of approximately \$454.6 million and \$30.0 million, respectively.

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Available-for-sale and trading securities consist of the following at March 31, 2010 (amounts in thousands):

	March 31, 2010				Fair Value
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-Than-Temporary Impairment Losses	
Corporate notes and bonds	\$ 135,285	\$ 590	\$ (90)	\$	\$ 135,785
Federal agency notes and bonds	320,250	363	(165)		320,448
Auction rate floating securities	34,400		(8,146)		26,254
Asset-backed securities	2,354	15		(260)	2,109
Total securities	\$ 492,289	\$ 968	\$ (8,401)	\$ (260)	\$ 484,596

During the three months ended March 31, 2010, the gross realized gains and losses on sales of available-for-sale securities were \$0. Gross unrealized gains and losses are determined based on the specific identification method. The net adjustment to unrealized gains during the three months ended March 31, 2010, on available-for-sale securities included in stockholders' equity totaled \$0.2 million. The amortized cost and estimated fair value of the available-for-sale securities at March 31, 2010, by maturity, are shown below (amounts in thousands):

	March 31, 2010	
	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	\$ 200,959	\$ 200,936
Due after one year through five years	256,931	257,406
Due after 10 years	33,100	24,956
	\$ 490,990	\$ 483,298

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations. At March 31, 2010, approximately \$30.0 million in estimated fair value expected to mature greater than one year has been classified as long-term investments since these investments are in an unrealized loss position, and management has both the ability and intent to hold these investments until recovery of fair value, which may be maturity.

As of March 31, 2010, the Company's investments included auction rate floating securities