

MEDICIS PHARMACEUTICAL CORP

Form 10-Q

August 10, 2009

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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 June 30, 2009

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

Outstanding at August 6, 2009

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Class A Common Stock \$.014 Par Value

59,410,511 (a)

(a) includes 1,947,414 shares of unvested restricted stock awards

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MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

| | June 30, 2009 (unaudited) | December 31, 2008 |
|----------------------------------------------------------------------------------|------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 133,782 | \$ 86,450 |
| Short-term investments | 271,608 | 257,435 |
| Accounts receivable, net | 97,409 | 52,588 |
| Inventories, net | 24,485 | 24,226 |
| Deferred tax assets, net | 62,420 | 53,161 |
| Other current assets | 20,675 | 19,676 |
| Total current assets | 610,379 | 493,536 |
| Property and equipment, net | 25,871 | 26,300 |
| Intangible assets: | | |
| Intangible assets related to product line acquisitions and business combinations | 337,541 | 267,624 |
| Other intangible assets | 7,669 | 7,752 |
| | 345,210 | 275,376 |
| Less: accumulated amortization | 120,464 | 113,947 |
| Net intangible assets | 224,746 | 161,429 |
| Goodwill | 93,669 | 156,762 |
| Deferred tax assets, net | 65,942 | 77,149 |
| Long-term investments | 36,935 | 55,333 |
| Other assets | 2,415 | 2,925 |
| | \$1,059,957 | \$ 973,434 |

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)

| | June 30, 2009 (unaudited) | December 31, 2008 |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|----------------------|
| Liabilities | | |
| Current liabilities: | | |
| Accounts payable | \$ 44,770 | \$ 39,032 |
| Reserve for sales returns | 57,674 | 59,611 |
| Income taxes payable | 19,372 | |
| Other current liabilities | 129,972 | 87,258 |
| Total current liabilities | 251,788 | 185,901 |
| Long-term liabilities: | | |
| Contingent convertible senior notes | 169,326 | 169,326 |
| Deferred revenue | 4,399 | 4,167 |
| Other liabilities | 7,489 | 10,346 |
| 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: 70,166,135 and 69,396,394 at June 30, 2009 and December 31, 2008, respectively | | |
| | 978 | 969 |
| Class B common stock, \$0.014 par value; shares authorized: 1,000,000; issued and outstanding: none | | |
| Additional paid-in capital | 675,592 | 661,703 |
| Accumulated other comprehensive income | (2,205) | 2,106 |
| Accumulated earnings | 296,578 | 282,284 |
| Less: Treasury stock, 12,733,488 and 12,678,559 shares at cost at June 30, 2009 and December 31, 2008, respectively | (343,988) | (343,368) |
| Total stockholders equity | 626,955 | 603,694 |
| | \$ 1,059,957 | \$ 973,434 |

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended | | Six Months Ended | |
|-----------------------------------------|--------------------|------------------|------------------|------------------|
| | June 30, 2009 | June 30, 2008 | June 30, 2009 | June 30, 2008 |
| Net product revenues | \$ 138,695 | \$ 133,039 | \$ 235,294 | \$ 258,092 |
| Net contract revenues | 2,551 | 4,410 | 5,770 | 8,260 |
| Net revenues | 141,246 | 137,449 | 241,064 | 266,352 |
| Cost of product revenues (1) | 13,067 | 9,204 | 22,512 | 20,337 |
| Gross profit | 128,179 | 128,245 | 218,552 | 246,015 |
| Operating expenses: | | | | |
| Selling, general and administrative (2) | 71,654 | 71,872 | 142,079 | 143,934 |
| Research and development (3) | 12,072 | 33,000 | 25,347 | 42,189 |
| Depreciation and amortization | 7,945 | 6,780 | 15,077 | 13,502 |
| Operating income | 36,508 | 16,593 | 36,049 | 46,390 |
| Other (income) expense, net | (2,243) | | 630 | 2,871 |
| Interest and investment income | (2,158) | (7,449) | (4,645) | (16,649) |
| Interest expense | 1,058 | 2,148 | 2,112 | 4,555 |
| Income before income tax expense | 39,851 | 21,894 | 37,952 | 55,613 |
| Income tax expense | 24,258 | 8,886 | 22,031 | 22,080 |
| Net income | \$ 15,593 | \$ 13,008 | \$ 15,921 | \$ 33,533 |
| Basic net income per share | \$ 0.26 | \$ 0.23 | \$ 0.27 | \$ 0.59 |
| Diluted net income per share | \$ 0.25 | \$ 0.21 | \$ 0.27 | \$ 0.52 |
| Cash dividend declared per common share | \$ 0.04 | \$ 0.04 | \$ 0.08 | \$ 0.08 |

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| | | | | |
|------------------------------------|--------|--------|--------|--------|
| Common shares used in calculating: | | | | |
| Basic net income per share | 57,088 | 56,493 | 56,911 | 56,425 |
| Diluted net income per share | 63,008 | 68,209 | 62,838 | 69,204 |

| | | | | |
|------------------------------------------------------------------------------------|----------|----------|-----------|-----------|
| (1) amounts exclude amortization of intangible assets related to acquired products | \$ 6,233 | \$ 5,346 | \$ 11,675 | \$ 10,633 |
| (2) amounts include share-based compensation expense | \$ 4,786 | \$ 4,601 | \$ 8,519 | \$ 8,930 |
| (3) amounts include share-based compensation expense | \$ 230 | \$ 51 | \$ 368 | \$ 112 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**MEDICIS PHARMACEUTICAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**
(in thousands)

| | Six Months Ended | |
|-----------------------------------------------------------------------------------|------------------|---------------|
| | June 30, 2009 | June 30, 2008 |
| Operating Activities: | | |
| Net income | \$ 15,921 | \$ 33,533 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 15,077 | 13,502 |
| Amortization of deferred financing fees | | 666 |
| Loss on disposal of property and equipment | | 36 |
| Gain on sale of product rights | (350) | |
| Gain on sale of Medicis Pediatrics | (2,915) | |
| Adjustment of impairment of available-for-sale investments | (33) | |
| Charge reducing value of investment in Revance | 2,886 | 2,871 |
| Gain on sale of available-for-sale investments, net | (76) | (947) |
| Share-based compensation expense | 8,887 | 9,042 |
| Deferred income tax benefit | (3,378) | (34,355) |
| Tax expense from exercise of stock options and vesting of restricted stock awards | (694) | (1,007) |
| Excess tax benefits from share-based payment arrangements | (169) | (167) |
| Increase in provision for sales discounts and chargebacks | 1,120 | 908 |
| Accretion (amortization) of premium/(discount) on investments | 1,416 | (919) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (45,941) | (10,503) |
| Inventories | (259) | 6,113 |
| Other current assets | (999) | 463 |
| Accounts payable | 5,738 | 5,093 |
| Reserve for sales returns | (1,937) | (3,244) |
| Income taxes payable | 19,372 | 27,023 |
| Other current liabilities | 39,925 | 2,159 |
| Other liabilities | (2,569) | (1,891) |
| Net cash provided by operating activities | 51,022 | 48,376 |
| Investing Activities: | | |
| Purchase of property and equipment | (2,828) | (7,252) |
| Payment of direct merger costs | | (306) |
| Payments for purchase of product rights | (74,932) | (405) |
| Proceeds from sale of product rights | 350 | |
| Proceeds from sale of Medicis Pediatrics | 70,294 | |
| Purchase of available-for-sale investments | (154,187) | (280,874) |
| Sale of available-for-sale investments | 71,201 | 364,739 |
| Maturity of available-for-sale investments | 84,276 | 267,363 |

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| | | |
|-----------------------------------------------------------|------------|------------|
| Net cash (used in) provided by investing activities | (5,826) | 343,265 |
| Financing Activities: | | |
| Payment of dividends | (4,663) | (3,992) |
| Payment of contingent convertible senior notes | | (283,729) |
| Excess tax benefits from share-based payment arrangements | 169 | 167 |
| Proceeds from the exercise of stock options | 6,807 | 3,532 |
| Net cash provided by (used in) financing activities | 2,313 | (284,022) |
| Effect of exchange rate on cash and cash equivalents | (177) | (62) |
| Net increase in cash and cash equivalents | 47,332 | 107,557 |
| Cash and cash equivalents at beginning of period | 86,450 | 108,046 |
| Cash and cash equivalents at end of period | \$ 133,782 | \$ 215,603 |

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009
(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 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 19 branded products. Its primary brands are DYSPORT™, PERLANE®, RESTYLANE®, SOLODYN®, TRIAZ®, VANOS® and ZIANA®. Medicis entered the non-invasive fat ablation 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, 2008. 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, 2008.

2. SHARE-BASED COMPENSATION

Stock Option and Restricted Stock Awards

At June 30, 2009, 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. Effective July 1, 2005, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*, 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 total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of June 30, 2009, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to June 30, 2009, was approximately \$3.1 million and the related weighted average period over which it is expected to be recognized is approximately 1.6 years.

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A summary of stock option activity within the Company's stock-based compensation plans and changes for the six months ended June 30, 2009 is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|------------------------------|-----------------------------|----------------------------------------------------|--------------------------------------------------------------------|------------------------------------------|
| Balance at December 31, 2008 | 10,707,357 | \$ 27.98 | | |
| Granted | 182,017 | \$ 13.94 | | |
| Exercised | (620,287) | \$ 10.97 | | |
| Terminated/expired | (260,375) | \$ 29.56 | | |
| Balance at June 30, 2009 | 10,008,712 | \$ 28.73 | 3.5 | \$ 511,714 |

The intrinsic value of options exercised during the six months ended June 30, 2009, was \$2,663,621. Options exercisable under the Company's share-based compensation plans at June 30, 2009, were 9,080,628, with a weighted average exercise price of \$28.45, a weighted average remaining contractual term of 3.3 years, and an aggregate intrinsic value of \$82,088.

A summary of outstanding stock options that are fully vested and are expected to vest, based on historical forfeiture rates, and those stock options that are exercisable, as of June 30, 2009, is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|------------------------------------------|-----------------------------|----------------------------------------------------|--------------------------------------------------------------------|------------------------------------------|
| Outstanding, net of expected forfeitures | 9,211,283 | \$28.78 | 3.5 | \$428,917 |
| Exercisable | 8,369,141 | \$28.50 | 3.3 | \$ 67,468 |

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, 2009 | Six Months Ended June 30, 2008 |
|---------------------------------|-----------------------------------------------|-----------------------------------------------|
| Expected dividend yield | 0.3% to 1.0% | 0.6% to 0.7% |
| Expected stock price volatility | 0.45 to 0.46 | 0.35 to 0.38 |
| Risk-free interest rate | 2.2% to 2.8% | 3.0% to 3.4% |
| 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. 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, 2009 and 2008, was \$6.44 and \$8.90, 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, 2009, 975,173 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 June 30, 2009 and 2008, was approximately \$2.3 million and \$1.5 million, respectively. Share-based compensation expense related to all restricted stock awards

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outstanding during the six months ended June 30, 2009 and 2008, was approximately \$4.1 million and \$2.6 million, respectively. As of June 30, 2009, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to June 30, 2009, was approximately \$29.2 million, and the related weighted average period over which it is expected to be recognized is approximately 3.4 years.

A summary of restricted stock activity within the Company's share-based compensation plans and changes for the six months ended June 30, 2009, is as follows:

| Nonvested Shares | Shares | Weighted Average Grant-Date Fair Value |
|--------------------------------|---------------|-----------------------------------------------------------|
| Nonvested at December 31, 2008 | 1,204,851 | \$ 23.38 |
| Granted | 975,173 | \$ 11.28 |
| Vested | (149,454) | \$ 25.07 |
| Forfeited | (31,772) | \$ 20.66 |
| Nonvested at June 30, 2009 | 1,998,798 | \$ 17.40 |

The total fair value of restricted shares vested during the six months ended June 30, 2009 and 2008, was approximately \$3.7 million and \$2.9 million, respectively.

Stock Appreciation Rights

During the six months ended June 30, 2009, the Company granted, in aggregate, 2,019,558 cash-settled stock appreciation rights (SARs) to over 200 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. SFAS No. 123R requires the fair value of SARs 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 and six months ended June 30, 2009, was approximately \$0.9 million and \$1.1 million, respectively. As of June 30, 2009, the total measured amount of unrecognized compensation cost related to outstanding SARs, to be recognized as expense subsequent to June 30, 2009, was approximately \$15.9 million, and the related weighted average period over which it is expected to be recognized is approximately 4.7 years.

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

| | SARs Granted During the Six Months Ended June 30, 2009 | Remeasurement as of June 30, 2009 |
|---------------------------------|---------------------------------------------------------------------------|--------------------------------------------------|
| Expected dividend yield | 0.3% to 1.0% | 1.0% |
| Expected stock price volatility | 0.45 to 0.46 | 0.42 |

| | | |
|-------------------------|--------------|-----------|
| Risk-free interest rate | 2.2% to 2.8% | 3.2% |
| Expected life of SARs | 7.0 Years | 6.7 Years |

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A summary of SARs activity for the six months ended June 30, 2009 is as follows:

| | Number of SARs | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|------------------------------|---------------------------|----------------------------------------------------|--------------------------------------------------------------------|------------------------------------------|
| Balance at December 31, 2008 | | \$ | | |
| Granted | 2,019,558 | \$ 11.29 | | |
| Exercised | | | | |
| Terminated/expired | (32,718) | \$ 11.28 | | |
| Balance at June 30, 2009 | 1,986,840 | \$ 11.29 | 6.7 | \$ 9,987,277 |

No SARs were exercisable as of June 30, 2009.

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 June 30, 2009, the Company has recorded the estimated fair value in available-for-sale and trading securities for short-term and long-term investments of approximately \$271.6 million and \$36.9 million, respectively.

Available-for-sale and trading securities consist of the following at June 30, 2009 (amounts in thousands):

| | June 30, 2009 | | | |
|-------------|-----------------------------|-----------------------------|------------------------------------------------------|-------------|
| | Gross Unrealized | Gross Unrealized | Other- Than- Temporary Impairment | Fair |
| Cost | &nb | | | |