MEDICIS PHARMACEUTICAL CORP
Form 10-Q
May 10, 2005

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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 March 31, 2005

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 an accelerated filer (as defined in Exchange Act Rule 12b-2) YES þ NO o

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 May 5, 2005
Class A Common Stock $.014 Par Value	54,263,826

MEDICIS PHARMACEUTICAL CORPORATION

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Part I. Financial Information

Item 1. Financial Statements

MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

	March 31, 2005 (unaudited)	June 30, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 68,173	$ 46,621
Short-term investments	493,081	587,419
Accounts receivable, net	48,004	47,858
Inventories, net	19,067	19,540
Deferred tax assets, net	15,642	14,104
Other current assets	15,560	18,321
Total current assets	659,527	733,863
Property and equipment, net	6,346	5,842
Intangible assets:		
Intangible assets related to product line acquisitions and business combinations	314,650	312,416
Other intangible assets	16,077	15,288
	330,727	327,704
Less: accumulated amortization	66,365	51,961
Net intangible assets	264,362	275,743
Goodwill	65,135	55,401
Deferred financing costs, net	5,933	7,535
Other non-current assets	7,096	
	$ 1,008,399	$ 1,078,384

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)

	March 31, 2005 (unaudited)	June 30, 2004
Liabilities		
Current liabilities:		
Accounts payable	$ 28,954	$ 13,912
Short-term contract obligation	27,491	17,891
Income taxes payable	4,759	712
Other current liabilities	27,624	34,605
Total current liabilities	88,828	67,120
Long-term liabilities:		
Contingent convertible senior notes	453,065	453,067
Deferred tax liability, net	4,890	2,894
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: 66,968,400 and 65,419,460 at March 31, 2005 and June 30, 2004, respectively	937	916
Class B common stock, $0.014 par value; shares authorized: 1,000,000; issued and outstanding: 0 and 758,032 at March 31, 2005 and June 30, 2004, respectively		10
Additional paid-in capital	537,867	517,468
Accumulated other comprehensive income	(1,163)	(1,020)
Deferred compensation	(825)	(1,212)
Accumulated earnings	265,708	230,049
Less: Treasury stock, 12,602,554 and 8,681,468 shares at cost at March 31, 2005 and at June 30, 2004, respectively	(340,908)	(190,908)
Total stockholders equity	461,616	555,303
	$ 1,008,399	$ 1,078,384

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,		Nine Months Ended March 31,	
	2005	2004	2005	2004
Net product revenues	$ 75,788	$ 80,974	$ 222,787	$ 211,572
Net contract revenues	19,400	865	53,568	4,195
Net revenues	95,188	81,839	276,355	215,767
Cost of product revenue (1)	13,914	13,118	41,185	34,536
Gross profit	81,274	68,721	235,170	181,231
Operating costs and expenses:				
Selling, general and administrative	31,934	28,793	97,670	87,907
Research and development	14,452	3,084	59,591	12,375
Depreciation and amortization	6,054	4,707	16,276	11,872
Operating costs and expenses	52,440	36,584	173,537	112,154
Operating income	28,834	32,137	61,633	69,077
Interest income	2,989	2,309	8,065	7,714
Interest expense	(2,658)	(2,644)	(7,982)	(8,163)
Loss on early extinguishment of debt				(58,660)
Income before income tax expense	29,165	31,802	61,716	9,968
Income tax expense	(9,794)	(11,131)	(21,121)	(2,833)
Net income	$ 19,371	$ 20,671	$ 40,595	$ 7,135
Basic net income per share	$ 0.36	$ 0.37	$ 0.73	$ 0.13

Diluted net income per share	$ 0.30	$ 0.31	$ 0.64	$ 0.12
Cash dividend declared per common share	$ 0.03	$ 0.025	$ 0.09	$ 0.075
Basic common shares outstanding	54,251	56,042	55,506	55,198
Diluted common shares outstanding	69,773	73,164	71,489	58,569

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(1) amounts exclude amortization of intangible assets related to acquired products as follows:	$ 5,342	$ 4,165	$ 14,274	$ 10,558

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(in thousands)

	Nine Months Ended	
	March 31, 2005	March 31, 2004
Operating Activities:		
Net income	$ 40,595	$ 7,135
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,884	13,491
Loss on disposal of property and equipment	36	
Loss (gain) on sale of available-for-sale investments	259	(396)
Amortization of deferred compensation	386	386
Deferred income tax expense (benefit)	458	(3,732)
Tax benefit from exercise of stock options	4,605	15,268
Provision for doubtful accounts and returns	3,100	1,250
Accretion of premium on investments	6,409	4,787
Loss on early extinguishment of debt		58,660
Changes in operating assets and liabilities:		
Accounts receivable	(3,246)	509
Inventories	474	(5,603)
Other current assets	2,761	(10,871)
Accounts payable	8,761	(4,704)
Income taxes payable	4,046	(422)
Other current liabilities	(7,174)	1,670
Net cash provided by operating activities	79,354	77,428
Investing Activities:		
Purchase of property and equipment	(2,411)	(3,658)
Payment of direct merger costs	(949)	(547)
Payments for purchase of product rights	(3,023)	(59,487)
Purchase of available-for-sale investments	(626,072)	(673,691)
Sale of available-for-sale investments	660,935	503,826
Maturity of available-for-sale investments	51,876	92,874
Decrease in restricted cash		53,837
Change in other assets		8
Net cash provided by (used in) investing activities	80,356	(86,838)
Financing Activities:		
Payment of deferred financing costs	(7)	(5,041)
Payment of dividends	(4,742)	(4,117)

Purchase of treasury stock	(150,000)	
Proceeds from the exercise of stock options	15,803	37,032
Net cash (used in) provided by financing activities	(138,946)	27,874
Effect of exchange rate on cash and cash equivalents	788	286
Net increase in cash and cash equivalents	21,552	18,750
Cash and cash equivalents at beginning of period	46,621	44,346
Cash and cash equivalents at end of period	$ 68,173	$ 63,096

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2005
(unaudited)

1. NATURE OF BUSINESS

Medicis Pharmaceutical Corporation is a leading specialty pharmaceutical company focusing primarily on helping patients attain a healthy and youthful appearance and self-image through the development and marketing of products in the United States for the treatment of dermatological, aesthetic and podiatric conditions. Medicis also markets products in Canada for the treatment of dermatological and aesthetic conditions. Medicis has built its business by executing a four-part growth strategy. This strategy consists of promoting existing core brands, developing new products and important product line extensions, entering into strategic collaborations, and acquiring complementary products, technologies and businesses.

The Company offers a broad range of products addressing various conditions including acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, eczema, skin and skin-structure infections, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 15 branded products. Its core brands are DYNACIN® (minocycline HCI), LOPROX® (ciclopirox), OMNICEF® (cefdinir), PLEXION® (sodium sulfacetamide/sulfur), RESTYLANE® (hyaluronic acid), TRIAZ® (benzoyl peroxide), and VANOS (fluocinonide) Cream, 0.1%.

In March 2003, Medicis expanded into the dermal aesthetic market through its acquisition of the exclusive United States and Canadian rights to market, distribute and commercialize the dermal restorative product lines known as RESTYLANE®, PERLANE and RESTYLANE FINE LINES from Q-Med AB, a Swedish biotechnology/medical device company and its affiliates, collectively Q-Med. RESTYLANE® has been approved by the Food and Drug Administration (the FDA) for use in the United States as a medical device for the correction of moderate to severe facial wrinkles and folds, such as nasolabial folds. RESTYLANE®, PERLANE and RESTYLANE FINE LINES have been approved for use in Canada.

The condensed consolidated financial statements include the accounts of Medicis Pharmaceutical Corporation and its wholly owned subsidiaries (Medicis or the Company). 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 condensed 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 fiscal year ended June 30, 2004. 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 fiscal 2004. Certain prior period amounts have been reclassified to conform with current period presentation.

2. CHANGE IN ESTIMATE

During the three months ended March 31, 2005, the Company changed the estimated useful life for certain intangible assets related to its merger with Ascent Pediatrics, Inc. (Ascent), based on management s determination that these intangible assets appear to have shorter useful lives than originally estimated. There is no cumulative effect for this change. The effect of this change on net income for the three months ended March 31, 2005 was to decrease net income by approximately $540,000 or $0.01 per diluted common share.

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3. STOCK-BASED COMPENSATION

At March 31, 2005, the Company had six stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations. Other than restricted stock, no stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), to stock-based employee compensation (amounts in thousands, except per share amounts):

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2005	2004	2005	2004
Net income, as reported	$ 19,371	$ 20,671	$ 40,595	$ 7,135
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	5,049	4,674	15,244	13,771
Pro-forma net income (loss)	$ 14,322	$ 15,997	$ 25,351	$ (6,636)
Earnings per share:				
Basic as reported	$ 0.36	$ 0.37	$ 0.73	$ 0.13
Basic pro forma	$ 0.26	$ 0.29	$ 0.46	$ (0.12)
Diluted as reported	$ 0.30	$ 0.31	$ 0.64	$ 0.12
Diluted pro forma	$ 0.23	$ 0.24	$ 0.42	$ (0.12)

As required, the pro forma disclosures above include options granted since April 1, 1996. Consequently, the effects of applying SFAS No. 123 for providing pro forma disclosures may not be representative of the effects on reported net income for future years until all options outstanding are included in the pro forma disclosures. For purposes of pro forma disclosures, the estimated fair value of stock-based compensation plans and other options is amortized to expense primarily over the vesting period.

On December 16, 2004, the FASB issued Statement No. 123R, Share-Based Payment (SFAS No. 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. Stock-based payments include stock option grants. The Company grants options to purchase common stock to some of its employees and directors under various plans at prices equal to the market value of the stock on the dates the options were granted. The Company is required to adopt SFAS No. 123R in its first quarter of fiscal 2006, beginning July 1, 2005. The Company has not yet adopted this pronouncement and is currently evaluating the expected impact that the adoption of SFAS No. 123R will have on its consolidated financial position, results of operations and cash flows; however, SFAS No. 123R will negatively impact the Company s earnings.

4. 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 makes up-front, non-refundable payments to third parties for new technologies and for research and development work that has been completed. These up-front payments may be expensed at the time of payment depending on the nature of the payment made.

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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.

On January 28, 2005, the Company amended its strategic alliance with aaiPharma Inc. (aaiPharma) previously initiated in June 2002 for the development, commercialization and license of a dermatologic product. The consummation of the amendment has not affected the timing of the development project. The amendment allowed for the immediate transfer of the work product as defined under the agreement, as well as the product s management and development, to Medicis, and provides that aaiPharma will continue to assist Medicis with the development of the product on a fee for services basis. Medicis will have no future financial obligations to pay aaiPharma on the attainment of clinical milestones, but incurred approximately $8.3 million as a charge to research and development expense during the three months ended March 31, 2005, as part of the amendment and the assumption of all liabilities associated with the project.

In addition to the amendment, Medicis entered into a supply agreement with aaiPharma for the eventual manufacture of the product by aaiPharma under certain conditions. Medicis has the right to qualify an alternate manufacturing facility, and aaiPharma agreed to assist Medicis in obtaining these qualifications. Upon the approval of the alternate facility and approval of the product, Medicis will pay aaiPharma approximately $1 million.

On December 13, 2004, the Company entered into an exclusive development and license agreement and other ancillary agreements with Ansata Therapeutics, Inc. (Ansata). The development and license agreement grants Medicis the exclusive, worldwide rights to Ansata s early stage, proprietary antimicrobial peptide technology. In accordance with the development and license agreement, Medicis paid $5 million upon signing of the contract and will pay approximately $9 million upon the successful completion of certain developmental milestones. Should Medicis continue with the development of this technology, the Company will incur additional milestone payments beyond the development and license agreement. The initial $5 million payment was recorded as a charge to research and development expense during the second quarter of fiscal 2005. The Company also incurred approximately $0.5 million of professional fees related to the completion of the agreements, which was included in selling, general and administrative expenses during the second quarter of fiscal 2005. In addition, the Company entered into an Option Agreement with Ansata where Medicis has the option to acquire Ansata or certain assets of Ansata if certain financial conditions are present.

On April 19, 1999, the Company acquired 100% of the common stock of Ucyclyd Pharma, Inc. (Ucyclyd), a privately held pharmaceutical company based in Baltimore, Maryland, for net cash of approximately $14.3 million. Ucyclyd s primary products, BUPHENYL® and AMMONUL®, are indicated in the treatment of Urea Cycle Disorder. Under terms of the agreement, the Company paid $15.1 million on April 19, 1999, and paid an additional $5.7 million in contingent payments in April 2000. In November 2004, the Company paid $2.7 million to the former shareholders of Ucyclyd as the final contractual purchase price payment. This $2.7 million payment was recorded as an addition to the original Ucyclyd intangible asset in the Company s condensed consolidated balance sheets.

On July 15, 2004, the Company entered into an exclusive license agreement and other ancillary documents with Q-Med to market, distribute, sell and commercialize in the United States and Canada Q-Med s product currently known as SubQ™. Q-Med has the exclusive right to manufacture SubQ™ for Medicis. SubQ™ is currently not approved for use in the United States or Canada. Under terms of the license agreement, Medicis Aesthetics Holdings Inc., a wholly owned subsidiary of Medicis, licenses SubQ™ for approximately $80 million, due as follows: approximately $30 million on July 15, 2004, which was recorded as a charge to research and development expense during the first quarter of fiscal 2005; approximately $10 million upon completion of certain clinical milestones; approximately $20 million upon satisfaction of certain defined regulatory milestones; and approximately $20 million

upon U.S. launch of SubQ™. In addition, the Company incurred approximately $0.7 million of professional fees related to the completion of the agreements during the first quarter of fiscal 2005, which was included in selling, general

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and administrative expenses. The Company also will make additional milestone payments to Q-Med upon the achievement of certain commercial milestones.

5. DEFINITIVE MERGER AGREEMENT WITH INAMED CORPORATION

On March 20, 2005, Medicis, a wholly-owned subsidiary of Medicis and Inamed Corporation (Inamed) entered into an Agreement and Plan of Merger. Inamed is a global healthcare company with over 25 years of experience developing, manufacturing and marketing innovative, high-quality, science-based products. Current products include breast implants for aesthetic augmentation and for reconstructive surgery; a range of dermal products to treat facial wrinkles; and minimally invasive devices for obesity intervention, including the LAP-BAND® system for morbid obesity.

Under the terms of the Agreement and Plan of Merger, Inamed will merge with and into a subsidiary of Medicis and each share of Inamed common stock will be converted into the right to receive 1.4205 shares of Medicis common stock and $30.00 in cash. The completion of the transaction is subject to several customary conditions, including the receipt of applicable approvals from Medicis and Inamed s stockholders, the absence of any material adverse effect on either party s business and the receipt of regulatory approvals. It is currently anticipated that the closing of the transaction would occur by the end of calendar 2005.

During the third quarter of fiscal 2005, the Company incurred approximately $7.1 million of professional and other costs related to the transaction. The costs are included in other non-current assets in the accompanying condensed consolidated balance sheets. The discussions in this report relate to Medicis as a stand-alone entity and do not reflect the impact of the proposed merger with Inamed.

The Agreement and Plan of Merger was filed with the SEC by the Company as part of an 8-K filed on March 21, 2005.

6. LICENSE OF ORAPRED® TO BIOMARIN

On May 18, 2004, the Company closed an asset purchase agreement and license agreement and executed a securities purchase agreement with BioMarin. The asset purchase agreement involves BioMarin s purchase of assets related to ORAPRED®, including assets concerning the Ascent field sales force. ORAPRED® and related pediatric intellectual property is owned by Ascent, a wholly owned subsidiary of Medicis. The license agreement granted BioMarin, among other things, the exclusive worldwide rights to ORAPRED®. The securities purchase agreement granted BioMarin the option to purchase all outstanding shares of common stock of Ascent, based on certain conditions. As part of the transaction, the name of Ascent Pediatrics, Inc. was changed to Medicis Pediatrics, Inc.

Under terms of the agreements, BioMarin was to make license payments to Ascent of approximately $93 million payable over a five-year period as follows: approximately $10 million as of the date of the transaction; approximately $12.5 million per quarter for four quarters beginning in July 2004; approximately $2.5 million per quarter for the subsequent four quarters beginning in July 2005; approximately $2 million per quarter for the subsequent eight quarters beginning in July 2006; and approximately $1.75 million per quarter for the last four quarters of the five-year period beginning in July 2008. BioMarin was also to make payments of $2.5 million per quarter for six quarters beginning in July 2004 for reimbursement of certain contingent payments as discussed in Note 8. As of March 31, 2005, BioMarin had paid $55.0 million to Medicis under the license agreement, which represents all scheduled payments due through that date under the license agreement. The license agreement will terminate in July 2009. At that time, based on certain conditions, BioMarin would have the option to purchase all outstanding shares of Ascent for approximately $82 million. The payment was to consist of $62 million in cash and $20 million in BioMarin common stock, based on the fair value of the stock at that time. The Company is responsible for the manufacture and delivery of finished goods inventory to BioMarin, and BioMarin is responsible for paying the Company for future finished goods inventory delivered through June 30, 2005. As a result, the Company is required to recognize the first

$60 million of license payments ratably through June 30, 2005. The Company has deferred approximately $0.9 million and $3.5 million in revenue under the agreement as of March 31, 2005, and June 30, 2004, respectively. The license payments

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received after June 30, 2005 and the reimbursement of contingent payments will be recognized as revenue when all four criteria of SAB 104 have been met.

As of the closing date of the transaction, BioMarin is responsible for all marketing and promotional efforts regarding the sale of ORAPRED®. As a result, Medicis no longer advertises and promotes any oral liquid prednisolone sodium phosphate solution product or any related line extension. During the term of the license agreement, Medicis will maintain ownership of the intellectual property and, consequently, will continue to amortize the related intangible assets. Payments received from BioMarin under the license agreement will be treated as contract revenue, which is included in net revenues in the condensed consolidated statements of income.

On January 12, 2005, BioMarin and the Company entered into amendments to the Securities Purchase Agreement and License Agreement entered into on May 18, 2004, a Convertible Promissory Note (Convertible Note) and a Settlement and Mutual Release Agreement (collectively the Agreements). Under the terms of the Agreements, transaction payments from BioMarin to Medicis previously totaling $175 million were reduced to $159 million. Beginning with license payments relating to ORAPRED® to be made by BioMarin after July 2005, license payments totaling $93 million were reduced pro rata to $88.4 million. Consideration to be received by Medicis from BioMarin in 2009 for the option relating to the purchase of all outstanding shares of Ascent Pediatrics were reduced from $82 million to $70.6 million. Medicis will take full financial responsibility for contingent payments due to former Ascent Pediatric shareholders without the $5 million offset payment that would have been paid by BioMarin to Medicis after July 1, 2005. Contingent payments are due to former Ascent Pediatric shareholders from Medicis only if revenue from Ascent Pediatric products exceeds certain thresholds. In addition, Medicis will reimburse BioMarin for actual returns, up to certain agreed-upon limits, of ORAPRED® finished goods received by BioMarin during the quarters ended December 31, 2004, March 31, 2005 and June 30, 2005.

Additionally, Medicis will make available to BioMarin a Convertible Note up to $25 million beginning July 1, 2005 based on certain terms and conditions including a change of control provision. Money advanced under the Convertible Note is convertible into BioMarin shares at a strike price equal to the BioMarin average closing price for the 20 trading days prior to such advance. The Convertible Note matures on the option purchase date in 2009 as defined in the Securities Purchase Agreement but may be repaid by BioMarin at any time prior to the option purchase date. In conjunction with the Agreements, BioMarin and Medicis have entered into a settlement and Mutual Release Agreement to forever discharge each other from any and all claims, demands, damages, debts, liabilities, actions and causes of action relating to the transaction consummated by the parties other than certain continuing obligations in accordance with the terms of the parties agreements.

7. AQUISITION OF DERMAL AESTHETIC ENHANCEMENT PRODUCTS FROM THE Q-MED GROUP

On March 10, 2003, Medicis acquired all outstanding shares of HA North American Sales AB from Q-Med, a Swedish biotechnology/medical device company. HA North American Sales AB holds a license for the exclusive U.S. and Canadian rights to market, distribute and commercialize the dermal restorative product lines known as RESTYLANE®, PERLANE and RESTYLANE FINE LINES. RESTYLANE® has been approved by the FDA for use in the United States. RESTYLANE®, PERLANE and RESTYLANE FINE LINES have been approved for use in Canada. Under terms of the agreements, a wholly owned subsidiary of Medicis acquired all outstanding shares of HA North American Sales AB for total consideration of approximately $160.0 million, payable upon the successful completion of certain milestones or events. Medicis paid $58.2 million upon closing of the transaction, $53.3 million in December 2003 upon FDA approval of RESTYLANE®, approximately $19.4 million in May 2004 upon certain cumulative commercial milestones being achieved and will pay approximately $29.1 million upon FDA approval of PERLANE. Payments and costs related to this acquisition are capitalized as an intangible asset and are amortized over 15 years beginning in March 2003.

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8. MERGER OF ASCENT PEDIATRICS, INC.

As part of its merger with Ascent completed in November 2001, the Company may be required to make contingent purchase price payments (Contingent Payments) for each of the first five years following closing based upon reaching certain sales threshold milestones on the Ascent products for each twelve month period ended November 15, 2006, subject to certain deductions and set-offs. From time to time the Company assesses the probability and likelihood of payment in the coming respective November period based on current sales trends. There can be no assurance that such payment will ultimately be made nor is the accrual of a liability an indication of current sales levels. During the quarter ended December 31, 2004, the threshold for the third year Contingent Payment was met, and approximately $9.6 million was recorded as an increase to goodwill and short-term contract obligation. A total of approximately $27.5 million is included in short-term contract obligation in the Company s condensed consolidated balance sheets as of March 31, 2005, representing the first three years Contingent Payments. Pursuant to the merger agreement, payment of the contingent portion of the purchase price will be withheld pending the final outcome of the litigation discussed in Part II of this Form 10-Q.

9. SEGMENT AND PRODUCT INFORMATION

The Company operates in one significant business segment: Pharmaceuticals. The Company s current pharmaceutical franchises are divided between the Dermatological and Non-dermatological fields. The Dermatological field represents products for the treatment of Acne and Acne-related dermatological conditions and Non-acne dermatological conditions. The Non-dermatological field represents products for the treatment of Asthma (until May 2004) and Urea Cycle Disorder. The Acne and Acne-related dermatological product lines include core brands DYNACIN®, PLEXION® and TRIAZ®. The Non-acne dermatological product lines include core brands LOPROX®, OMNICEF®, RESTYLANE® and VANOS. The Non-dermatological product lines include AMMONUL®, BUPHENYL® and ORAPRED®.ORAPRED® was one of the Company s core brands until it was licensed to BioMarin in May 2004. The Non-dermatological field also includes contract revenues associated with licensing agreements and authorized generics.

The Company s pharmaceutical products, with the exception of AMMONUL® and BUPHENYL®, are promoted to dermatologists, podiatrists and plastic surgeons. Such products are often prescribed by physicians outside these three specialties; including family practitioners, general practitioners, primary-care physicians and OB/GYNs, as well as hospitals, government agencies and others. All products, with the exception of AMMONUL® and BUPHENYL®, are sold primarily to wholesalers and retail chain drug stores. AMMONUL® and BUPHENYL® are primarily sold directly to hospitals and pharmacies. Prior to the Company s licensing of ORAPRED® to BioMarin in May 2004, the Company also promoted its pharmaceutical products to pediatricians.

The percentage of net revenues for each of the product categories is as follows: