MEDICIS PHARMACEUTICAL CORP
Form 10-Q
August 09, 2011

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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, 2011

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: 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 þ No o

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 þ No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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	Outstanding at August 3, 2011
Class A Common Stock $.014 Par Value	

63,358,951 (a)

(a) includes 2,046,565 shares of unvested restricted stock awards

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Part I. Financial Information
Item 1. Financial Statements

MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	June 30, 2011 (unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 150,201	$ 218,362
Short-term investments	655,555	485,192
Accounts receivable, net	166,399	130,622
Inventories, net	30,829	35,282
Deferred tax assets, net	24,602	70,461
Other current assets	19,264	15,268
Assets held for sale from discontinued operations	10,248	13,127
Total current assets	1,057,098	968,314
Property and equipment, net	23,683	24,435
Net intangible assets	197,283	195,308
Goodwill	92,398	92,398
Deferred tax assets, net	95,516	36,898
Long-term investments	22,379	21,480
Other assets	2,991	2,991
	$ 1,491,348	$ 1,341,824

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, 2011 (unaudited)	December 31, 2010
Liabilities		
Current liabilities:		
Accounts payable	$ 45,393	$ 41,015
Current portion of contingent convertible senior notes	169,145	
Reserve for sales returns	78,220	60,692
Accrued consumer rebates and loyalty programs	124,922	101,678
Managed care and Medicaid reserves	51,239	49,375
Income taxes payable		4,628
Other current liabilities	73,764	75,228
Liabilities held for sale from discontinued operations	7,172	7,276
Total current liabilities	549,855	339,892
Long-term liabilities:		
Contingent convertible senior notes	181	169,326
Other liabilities	38,982	5,084
Stockholders Equity		
Preferred stock, $0.01 par value; shares authorized: 5,000,000; issued and outstanding: none		
Class A common stock, $0.014 par value; shares authorized: 150,000,000; issued and outstanding: 74,272,334 and 71,863,191 at June 30, 2011 and December 31, 2010, respectively	1,023	995
Class B common stock, $0.014 par value; shares authorized: 1,000,000; issued and outstanding: none		
Additional paid-in capital	778,120	715,651
Accumulated other comprehensive loss	(23,298)	(2,149)
Accumulated earnings	498,907	460,716
Less: Treasury stock, 13,059,002 and 12,897,610 shares at cost at June 30, 2011 and December 31, 2010, respectively	(352,422)	(347,691)
Total stockholders equity	902,330	827,522
	$ 1,491,348	$ 1,341,824

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		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Net product revenues	$ 189,819	$ 171,734	$ 353,715	$ 335,326
Net contract revenues	1,008	1,862	2,025	3,812
Net revenues	190,827	173,596	355,740	339,138
Cost of product revenues (1)	18,237	16,330	32,568	31,437
Gross profit	172,590	157,266	323,172	307,701
Operating expenses:				
Selling, general and administrative (2)	90,393	77,091	175,023	149,375
Research and development (3)	15,195	7,420	29,468	13,979
Depreciation and amortization	7,110	6,916	14,434	13,649
Operating income	59,892	65,839	104,247	130,698
Interest and investment income	(1,238)	(780)	(2,512)	(1,940)
Interest expense	1,141	1,061	2,199	2,119
Other expense, net		(2)		257
Income from continuing operations before income tax expense	59,989	65,560	104,560	130,262
Income tax expense	25,477	24,632	43,363	49,316
Net income from continuing operations	34,512	40,928	61,197	80,946
Loss from discontinued operations, net of income tax benefit	5,729	4,428	13,054	9,078
Net income	$ 28,783	$ 36,500	$ 48,143	$ 71,868
Basic net income per share continuing operations	$ 0.55	$ 0.68	$ 0.99	$ 1.35

Basic net loss per share discontinued operations	$ (0.09)	$ (0.08)	$ (0.22)	$ (0.16)
Basic net income per share	$ 0.46	$ 0.61	$ 0.78	$ 1.19
Diluted net income per share continuing operations	$ 0.51	$ 0.62	$ 0.91	$ 1.24
Diluted net loss per share discontinued operations	$ (0.09)	$ (0.08)	$ (0.22)	$ (0.16)
Diluted net income per share	$ 0.43	$ 0.56	$ 0.72	$ 1.10
Cash dividend declared per common share	$ 0.08	$ 0.06	$ 0.16	$ 0.12
Common shares used in calculating:				
Basic net income per share	60,308	58,271	59,719	58,161
Diluted net income per share	67,140	64,395	66,347	64,294
(1) amounts exclude amortization of intangible assets related to acquired products	$ 5,266	$ 5,184	$ 10,718	$ 10,368
(2) amounts include share-based compensation expense	$ 8,705	$ 2,070	$ 14,989	$ 4,957
(3) amounts include share-based compensation expense	$ 615	$ 44	$ 1,020	$ 100

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, 2011	June 30, 2010
Operating Activities:		
Net income	$ 48,143	$ 71,868
Loss from discontinued operations, net of income tax benefit	13,054	9,078
Net income from continuing operations	61,197	80,946
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	14,434	13,649
Amortization of prior service costs, supplemental executive retirement plan	400	
Adjustment of impairment of available-for-sale investments		260
(Gain) loss on sale of available-for-sale investments, net	(27)	750
Share-based compensation expense	16,009	5,057
Deferred income tax (benefit) expense	(877)	7,099
Tax benefit (expense) from exercise of stock options and vesting of restricted stock awards	1,864	(269)
Excess tax benefits from share-based payment arrangements	(2,872)	(320)
Increase in provision for sales discounts and chargebacks	1,163	1,031
Accretion of premium on investments	2,604	1,811
Changes in operating assets and liabilities:		
Accounts receivable	(36,940)	(42,849)
Inventories	4,453	(10,413)
Other current assets	(3,995)	(3,810)
Accounts payable	4,378	14,972
Reserve for sales returns	17,528	1,131
Accrued consumer rebates and loyalty programs	23,244	17,053
Managed care and Medicaid reserves	1,863	(2,668)
Income taxes payable	(4,628)	(13,923)
Other current liabilities	(17,338)	(2,282)
Other liabilities	128	(1,958)
Net cash provided by operating activities from continuing operations	82,588	65,267
Net cash used in operating activities from discontinued operations	(9,978)	(5,274)
Net cash provided by operating activities	72,610	59,993
Investing Activities:		
Purchase of property and equipment	(2,834)	(3,922)
Payments for purchase of product rights	(12,824)	768

Purchase of available-for-sale investments	(474,810)	(273,402)
Sale of available-for-sale investments	112,379	41,238
Maturity of available-for-sale investments	188,865	69,515
Net cash used in investing activities from continuing operations	(189,224)	(165,803)
Net cash used in investing activities from discontinued operations		(577)
Net cash used in investing activities	(189,224)	(166,380)
Financing Activities:		
Payment of dividends	(8,535)	(5,993)
Excess tax benefits from share-based payment arrangements	2,872	320
Proceeds from the exercise of stock options	54,049	2,206
Net cash provided by (used in) financing activities	48,386	(3,467)
Effect of exchange rate on cash and cash equivalents	67	(34)
Net decrease in cash and cash equivalents	(68,161)	(109,888)
Cash and cash equivalents at beginning of period	218,362	207,941
Cash and cash equivalents at end of period	$ 150,201	$ 98,053

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2011
(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, hyperpigmentation, photoaging, psoriasis, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 13 branded products. Its primary brands are DYSPORT®, PERLANE®, RESTYLANE®, SOLODYN®, VANOS® and ZIANA®. Medicis entered the non-invasive body contouring market with its acquisition of LipoSonix in July 2008. Beginning in the first quarter of 2011, the Company classifies the LipoSonix business as a discontinued operation for financial statement reporting purposes. See Note 2.

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, 2010. 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, 2010.

2. DISCONTINUED OPERATIONS

On February 25, 2011, the Company announced that as a result of the Company s strategic planning process and the current regulatory and commercial capital equipment environment, the Company has determined to explore strategic alternatives for its LipoSonix business including, but not limited to, the sale of the stand-alone business. The Company has engaged an investment banking firm to assist the Company in its exploration of strategic alternatives for LipoSonix. The Company expects the disposal of the LipoSonix business to take place by February 2012 or before. As a result of this decision, the Company now classifies the LipoSonix business as a discontinued operation for financial statement reporting purposes, including comparable period results.

Intangible assets and property and equipment related to LipoSonix were determined to be impaired as of December 31, 2010, based on the Company s analysis of the long-lived assets carrying value and projected future cash flows. As a result of the impairment analysis, the Company recorded a write-down of approximately $7.7 million related to LipoSonix intangible assets and $2.1 million related to LipoSonix property and equipment during the three months ended December 31, 2010. The write-down of intangible assets and property and equipment related to LipoSonix represented the full carrying value of the respective assets as of December 31, 2010. Therefore, no depreciation or amortization expense was recognized during the six months ended June 30, 2011 related to the discontinued operations, as the long-lived assets of the discontinued operations were written down to $0 as of December 31, 2010.

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The following is a summary of loss from discontinued operations, net of income tax benefit, for the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Net revenues	$ 200	$ 448	$ 356	$ 1,397
Cost of revenues	82	196	2,456	846
Gross profit	118	252	(2,100)	551
Operating expenses:				
Selling, general and administrative	5,731	3,782	11,594	7,542
Research and development	3,302	3,091	6,648	6,601
Depreciation and amortization		323		643
Loss from discontinued operations before income tax benefit	(8,915)	(6,944)	(20,342)	(14,235)
Income tax benefit	(3,186)	(2,516)	(7,288)	(5,157)
Loss from discontinued operations, net of income tax benefit	$ (5,729)	$ (4,428)	$ (13,054)	$ (9,078)

The Company includes only revenues and costs directly attributable to the discontinued operations, and not those attributable to the ongoing entity. Accordingly, no interest expense or general corporate overhead costs have been allocated to the LipoSonix discontinued operations. Included in cost of revenues for the six months ended June 30, 2011 was a $1.9 million charge related to an increase in the valuation reserve for LipoSonix inventory that is not expected to be sold.

The following is a summary of assets and liabilities held for sale associated with the LipoSonix discontinued operations as of June 30, 2011 and December 31, 2010 (in thousands):

	June 30, 2011	December 31, 2010
Cash and cash equivalents	$ 878	$ 629
Accounts receivable, net	83	129
Inventories, net	3,815	4,495
Deferred tax assets, net	5,191	7,328
Other assets	281	546
Assets held for sale from discontinued operations	$ 10,248	$ 13,127

Accounts payable	$	2,228	$	1,802
Other liabilities		4,944		5,474
Liabilities held for sale from discontinued operations	$	7,172	$	7,276

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The following is a summary of net cash used in operating activities from discontinued operations for the six months ended June 30, 2011 and 2010 (in thousands):

	Six Months Ended	
	June 30, 2011	June 30, 2010
Loss from discontinued operations, net of income tax benefit	$ (13,054)	$ (9,078)
Depreciation and amortization		643
Share-based compensation expense	1,795	327
Decrease in assets held for sale from discontinued operations	2,879	3,563
Decrease in liabilities held for sale from discontinued operations	(1,598)	(729)
Net cash used in operating activities from discontinued operations	$ (9,978)	$ (5,274)

Net cash used in investing activities from discontinued operations of $0.6 million for the six months ended June 30, 2010 represents purchases of property and equipment.

3. SHARE-BASED COMPENSATION

At June 30, 2011, 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

Stock option awards 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 June 30, 2011, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to June 30, 2011, was approximately $1.5 million and the related weighted average period over which it is expected to be recognized is approximately 2.6 years. All of the unrecognized compensation cost related to stock option awards relates to continuing operations.

A summary of stock option activity within the Company s stock-based compensation plans and changes for the six months ended June 30, 2011, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2010	6,491,353	$ 30.01		
Granted	79,933	$ 34.30		
Exercised	(1,984,481)	$ 27.64		
Terminated/expired	(80,705)	$ 36.82		
Balance at June 30, 2011	4,506,100	$ 31.01	2.7	$ 32,807,450

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The intrinsic value of options exercised during the six months ended June 30, 2011 was $16,015,062. Options exercisable under the Company s share-based compensation plans at June 30, 2011 were 4,352,288, with a weighted average exercise price of $31.18, a weighted average remaining contractual term of 2.6 years, and an aggregate intrinsic value of $30,957,994.

A summary of outstanding and exercisable stock options that are fully vested and are expected to vest, based on historical forfeiture rates, as of June 30, 2011, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, net of expected forfeitures	4,238,744	$ 31.19	2.7	$ 30,085,482
Exercisable, net of expected forfeitures	4,124,910	$ 31.27	2.6	$ 28,950,668

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, 2011	June 30, 2010
Expected dividend yield	0.77% to 0.88%	1.02% to 1.06%
Expected stock price volatility	0.33	0.33
Risk-free interest rate	2.47% to 2.81%	2.82% to 3.04%
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 six months ended June 30, 2011 and 2010, was $12.25 and $8.28, respectively.

Restricted Stock Awards

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. As of June 30, 2011, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to June 30, 2011, was approximately $40.7 million, and the related weighted average period over which it is expected to be recognized is approximately 3.4 years. Included in the $40.7 million of total unrecognized compensation cost related to nonvested restricted stock awards is $2.6 million related to discontinued operations.

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A summary of restricted stock activity within the Company s share-based compensation plans and changes for the six months ended June 30, 2011, is as follows:

Nonvested Shares	Shares	Weighted Average Grant-Date Fair Value
Nonvested at December 31, 2010	1,794,445	$ 17.94
Granted	757,310	$ 31.47
Vested	(445,912)	$ 19.11
Forfeited	(25,373)	$ 23.96
Nonvested at June 30, 2011	2,080,470	$ 22.54

The total fair value of restricted shares vested during the six months ended June 30, 2011 and 2010 was approximately $8.5 million and $6.6 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 SAR is expensed over the service period of the employee receiving the grant, 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. As of June 30, 2011, the total measured amount of unrecognized compensation cost related to outstanding SARs, to be recognized as expense subsequent to June 30, 2011, based on the remeasurement at June 30, 2011, was approximately $42.1 million, and the related weighted average period over which it is expected to be recognized is approximately 3.2 years. Included in the $42.1 million of total measured unrecognized compensation cost related to outstanding SARs is $5.3 million related to discontinued operations.

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 the Six Months Ended June 30, 2011	SARs Granted During the Six Months Ended June 30, 2010	Remeasurement as of June 30, 2011
Expected dividend yield	0.87%	0.95% to 1.06%	0.84%
Expected stock price volatility	0.32	0.32 to 0.33	0.31
Risk-free interest rate	3.12%	3.04% to 3.07%	1.76% to 2.50%

Expected life of SARs	7.0 Years	7.0 Years	4.7 to 6.6 Years

The weighted average fair value of SARs granted during the six months ended June 30, 2011 and 2010, as of the respective grant dates, was $9.90 and $8.14, respectively. The weighted average fair value of all SARs outstanding as of the remeasurement date of June 30, 2011 was $22.40.

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A summary of SARs activity for the six months ended June 30, 2011 is as follows:

	Number of SARs	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2010	3,030,142	$ 16.99		
Granted	64,135	$ 27.56		
Exercised	(272,120)	$ 15.48		
Terminated/expired	(166,185)	$ 15.99		
Balance at June 30, 2011	2,655,972	$ 17.46	5.2	$ 54,994,411

The intrinsic value of SARs exercised during the six months ended June 30, 2011 was $4,937,860.

As of June 30, 2011, 88,455 SARs were exercisable, with a weighted average exercise price of $14.69, a weighted average remaining contractual term of 4.7 years, and an aggregate intrinsic value of $1,911,063.

Total share-based compensation expense related to continuing operations recognized during the three months and six months ended June 30, 2011 and 2010 was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Stock options	$ 234	$ 385	$ 484	$ 838
Restricted stock awards	3,197	1,291	5,799	3,176
Stock appreciation rights	5,889	438	9,726	1,043
Total share-based compensation expense	$ 9,320	$ 2,114	$ 16,009	$ 5,057

4. SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

On June 24, 2011, the Company s Compensation Committee adopted the Medicis Pharmaceutical Supplemental Executive Retirement Plan (the SERP), a non-qualified, noncontributory, defined benefit pension plan that provides supplemental retirement income for a select group of officers, including the Company s named executive officers. The SERP is effective as of June 1, 2011. Retirement benefits are based on a SERP participant s years of service and average earnings (base salary plus cash bonus or incentive payments) during any three calendar years of service (regardless of whether the years are consecutive), beginning with the 2009 calendar year.

A SERP participant vests in 1/6th of his or her retirement benefit per plan year, effective as of the first day of the plan year, and becomes fully vested in his or her accrued retirement benefit upon (1) the participant s normal retirement date, provided that the participant has at least fifteen years of service with the Company and is employed by the Company on such date, (2) the participant s separation from service due to a discharge without cause or resignation for good reason (as such terms are defined in the participant s employment agreement, or in the absence of such employment agreement or definitions, in the Company s Executive Retention Plan), or (3) a change in control of the Company. A SERP participant accrues his or her retirement benefit based on (x) the participant s number of years of service with the Company (including prior years of service), divided by (y) the number of years designated for such

participant s tier (which ranges from five to twenty years).

Participants in the SERP received credit for prior service with the Company. The prior service accrued benefit of approximately $33.8 million was recorded as other comprehensive income within stockholders equity, and is amortized as compensation expense over the remaining service years of each participant. Amortization of

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prior service costs recognized as compensation expense during the three months ended June 30, 2011, was approximately $0.4 million, representing one month of amortization. The Company also established a deferred tax asset of approximately $12.0 million, the benefit of which was also recorded in other comprehensive income.

No investments were held by the Company related to the SERP as of June 30, 2011.

5. 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, 2011, the Company has recorded the estimated fair value of available-for-sale securities in short-term and long-term investments of approximately $655.6 million and $22.4 million, respectively.

Available-for-sale securities consist of the following at June 30, 2011 (in thousands):

	June 30, 2011				
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-Than-Temporary Impairment Losses	Fair Value
Corporate notes and bonds	$ 360,758	$ 474	$ (128)	$	$ 361,104
Federal agency notes and bonds	251,136	769	(8)		251,897
Auction rate floating securities	26,575		(6,691)		19,884
Asset-backed securities	45,011	38			45,049
Total securities	$ 683,480	$ 1,281	$ (6,827)	$	$ 677,934

During the three and six months ended June 30, 2011, there were no significant gross realized gains and losses on sales of available-for-sale securities. Gross unrealized gains and losses are determined based on the specific identification method. The net adjustment to unrealized losses during the six months ended June 30, 2011, 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 June 30, 2011, by maturity, are shown below (in thousands):

	June 30, 2011	
	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	$ 327,303	$ 327,965
Due after one year through five years	329,602	330,085

Due after 10 years	26,575	19,884
	$ 683,480	$ 677,934

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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 June 30, 2011, approximately $22.4 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 June 30, 2011, the Company s investments included auction rate floating securities with a fair value of $19.9 million. The Company s auction rate floating securities are debt instruments with a long-term maturity and with an interest rate that is reset in short intervals through auctions. The negative conditions in the credit markets from 2008 through the first half of 2011 have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008, the Company was informed that there was insufficient demand at auction for the auction rate floating securities. As a result, these affected auction rate floating securities are now considered illiquid, and the Company could be required to hold them until they are redeemed by the holder at maturity. The Company may not be able to liquidate the securities until a future auction on these investments is successful.

During the three months ended March 31, 2010, the Company became aware of new circumstances that directly impacted the valuation of an asset-backed security that is owned by the Company. An unrealized loss on the asset-backed security, based on the Company s intent to hold the security until recovery of the fair value, had previously been recorded in stockholders equity. Based on the new circumstances related to the investment, the Company determined that the impairment of the asset-backed security was other-than-temporary, as the Company believed it would not recover its investment even if the asset were held to maturity. A $0.3 million impairment charge was therefore recorded in other expense, net, during the three months ended March 31, 2010 related to the asset-backed security. The asset-backed security was sold in April 2010.

The following table shows the gross unrealized losses and the fair value of the Company s investments, with unrealized losses that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2011 (in thousands):

	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Corporate notes and bonds	$ 79,304	$ 128	$	$
Federal agency notes and bonds	18,892	8		
Auction rate floating securities			19,884	6,691
Asset-backed securities	1,790			
Total securities	$ 99,986	$ 136	$ 19,884	$ 6,691

As of June 30, 2011, the Company has concluded that the unrealized losses on its investment securities are temporary in nature and are caused by changes in credit spreads and liquidity issues in the marketplace. Available-for-sale securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security s performance and the creditworthiness of the issuer. Additionally, the Company does not intend to sell and it is not more-likely-than-not that the Company will be required to sell any of the securities before the recovery of their amortized cost basis.

6. FAIR VALUE MEASUREMENTS

As of June 30, 2011, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included certain of the Company s short-term and long-term investments, including investments in auction rate floating securities.

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The Company has invested in auction rate floating securities, which are classified as available-for-sale securities and reflected at fair value. Due to events in credit markets, the auction events for some of these instruments held by the Company failed during the three months ended March 31, 2008 (see Note 5). Therefore, the fair values of these auction rate floating securities, which are primarily rated AAA, are estimated utilizing a discounted cash flow analysis as of June 30, 2011. These analyses consider, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These investments were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company. Changes to these assumptions in future periods could result in additional declines in fair value of the auction rate floating securities.

The Company s assets measured at fair value on a recurring basis subject to the disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, at June 30, 2011, were as follows (in thousands):

		Fair Value Measurement at Reporting Date Using		
	June 30, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate notes and bonds	$ 361,104	$ 361,104	$	$
Federal agency notes and bonds	251,897	251,897		
Auction rate floating securities	19,884			19,884
Asset-backed securities	45,049	45,049		
Total assets measured at fair value	$ 677,934	$ 658,050	$	$ 19,884

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The following tables present the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2011 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Floating Securities
Balance at March 31, 2011	$ 20,772
Transfers to (from) Level 3	
Total gains (losses) included in other (income) expense, net	
Total gains included in other comprehensive income	12
Purchases	
Settlements	(900)
Balance at June 30, 2011	$ 19,884

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Floating Securities
Balance at December 31, 2010	$ 21,480
Transfers to (from) Level 3	
Total gains (losses) included in other (income) expense, net	
Total gains included in other comprehensive income	404
Purchases	
Settlements	(2,000)
Balance at June 30, 2011	$ 19,884

7. RESEARCH AND DEVELOPMENT

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

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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 which are in the development phase and to which the Company has no assurance that the third party will successfully complete its development milestones, the Company expenses such payments.

Research and development expense for the three and six months ended June 30, 2011 and 2010 are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Ongoing research and development costs	$ 7,080	$ 7,376	$ 13,948	$ 13,879
Payments related to strategic collaborations	7,500		14,500	
Share-based compensation expense	615	44	1,020	100
Total research and development	$ 15,195	$ 7,420	$ 29,468	$ 13,979

8. STRATEGIC COLLABORATIONS

Collaboration with a privately-held U.S. biotechnology company

On September 10, 2010, the Company and a privately-held U.S. biotechnology company entered into a sublicense and development agreement to develop an agent for specific dermatological conditions in the Americas and Europe and a purchase option to acquire the privately-held U.S. biotechnology company.

Under the terms of the agreements, the Company paid the privately-held U.S. biotechnology company $5.0 million in connection with the execution of the agreement, and will pay additional potential milestone payments totaling approximately $100.5 million upon successful completion of certain clinical, regulatory and commercial milestones.

During the three months ended December 31, 2010 and June 30, 2011, development milestones were achieved, and the Company made a $10.0 million and a $5.5 million payment, respectively, pursuant to the agreements. The initial $5.0 million payment, the $10.0 million milestone payment and the $5.5 million milestone payment were recognized as research and development expense during the three months ended September 30, 2010, December 31, 2010 and June 30, 2011, respectively.

Anacor

On February 9, 2011, the Company entered into a research and development agreement with Anacor Pharmaceuticals, Inc. (Anacor) for the discovery and development of boron-based small molecule compounds directed against a target for the potential treatment of acne. Under the terms of the agreement, the Company paid Anacor $7.0 million in connection with the execution of the agreement, and will pay up to $153.0 million upon the achievement of certain research, development, regulatory and commercial milestones, as well as royalties on sales by the Company. Anacor will be responsible for discovering and conducting the early development of product candidates which utilize Anacor s proprietary boron chemistry platform, while the Company will have an option to obtain an exclusive license for products covered by the agreement. The initial $7.0 million payment was recognized as research and development expense during the three months ended March 31, 2011.

9. SEGMENT AND PRODUCT INFORMATION

The Company operates in one 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 urea cycle disorder and contract revenue. The acne and acne-related dermatological product lines include SOLODYN® and ZIANA®. During early 2011, the Company discontinued its TRIAZ® branded products and decided to no longer promote its PLEXION® branded

products. The non-acne dermatological product lines include DYSPORT®, LOPROX®,

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PERLANE®, RESTYLANE® and VANOS®. The non-dermatological product lines include AMMONUL® and BUPHENYL®. 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 and plastic surgeons. Such products are often prescribed by physicians outside these two specialties, including family practitioners, general practitioners, primary-care physicians and OB/GYNs, as well as hospitals, government agencies, and others. Currently, the Company s products are sold primarily to wholesalers and retail chain drug stores.

Net revenues and the percentage of net revenues for each of the product categories are as follows (amounts in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Acne and acne-related dermatological products	$ 123,130	$ 124,763	$ 226,592	$ 244,976
Non-acne dermatological products	57,719	41,017	109,940	75,269
Non-dermatological products	9,978	7,816	19,208	18,893
Total net revenues	$ 190,827	$ 173,596	$ 355,740	$ 339,138

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Acne and acne-related dermatological products	65%	72%	64%	72%
Non-acne dermatological products	30	24	31	22
Non-dermatological products	5	4	5	6
Total net revenues	100%	100%	100%	100%

10. INVENTORIES

The Company primarily utilizes third parties to manufacture and package inventories held for sale, takes title to certain inventories once manufactured, and warehouses such goods until packaged for final distribution and sale. Inventories consist of salable products held at the Company s warehouses, as well as raw materials and components at the manufacturers facilities, and are valued at the lower of cost or market using the first-in, first-out method. The Company provides valuation reserves for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions.

Inventory costs associated with products that have not yet received regulatory approval are capitalized if, in the view of the Company s management, there is probable future commercial use and future economic benefit. If future commercial use and future economic benefit are not considered probable, then costs associated with pre-launch inventory that has not yet received regulatory approval are expensed as research and development expense during the period the costs are incurred. As of June 30, 2011 and December 31, 2010, there were no costs capitalized into inventory for products that had not yet received regulatory approval.

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Inventories are as follows (in thousands):

	June 30, 2011	December 31, 2010
Raw materials	$ 12,103	$ 15,801
Work-in-process	3,370	3,236
Finished goods	19,930	24,838
Valuation reserve	(4,574)	(8,593)
Total inventories	$ 30,829	$ 35,282

11. OTHER CURRENT LIABILITIES

Other current liabilities are as follows (in thousands):

	June 30, 2011	December 31, 2010
Accrued incentives, including SARs liability	$ 33,346	$ 33,923
Deferred revenue	13,799	16,422
Other accrued expenses	26,619	24,883
	$ 73,764	$ 75,228

Deferred revenue is comprised of the following (in thousands):

	June 30, 2011	December 31, 2010
Deferred revenue aesthetics products, net of cost of revenue	$ 9,802	$ 10,334
Deferred contract revenue	1,467	3,014
Deferred revenue sales into distribution channel in excess of eight weeks of projected demand	2,441	582
Other deferred revenue	89	2,492
	$ 13,799	$ 16,422

The Company defers revenue, and the related cost of revenue, of its aesthetics products, including DYSPORT®, PERLANE® and RESTYLANE®, until its exclusive U.S. distributor ships the product to physicians. Deferred contract revenue primarily relates to the Company s strategic collaboration with Hyperion Therapeutics, Inc. The Company also defers the recognition of revenue for certain sales of inventory into the distribution channel that are in excess of eight (8) weeks of projected demand.

12. CONTINGENT CONVERTIBLE SENIOR NOTES

In June 2002, the Company sold $400.0 million aggregate principal amount of its 2.5% Contingent Convertible Senior Notes Due 2032 (the Old Notes) in private transactions. As discussed below, approximately $230.8 million in principal amount of the Old Notes was exchanged for New Notes on August 14, 2003. The Old Notes bear interest at a rate of 2.5% per annum, which is payable on June 4 and December 4 of each year, beginning on December 4, 2002. The Company also agreed to pay contingent interest at a rate equal to 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2007, if the average trading price of the Old Notes reaches certain thresholds. Contingent interest of $0.1 million was payable at June 30, 2011. No contingent interest related to the Old Notes was payable at December 31, 2010. The Old Notes will mature on June 4, 2032.

The Company may redeem some or all of the Old Notes at any time on or after June 11, 2007, at a redemption price, payable in cash, of 100% of the principal amount of the Old Notes, plus accrued and unpaid

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interest, including contingent interest, if any. Holders of the Old Notes may require the Company to repurchase all or a portion of their Old Notes on June 4, 2012 and June 4, 2017, or upon a change in control, as defined in the indenture governing the Old Notes, at 100% of the principal amount of the Old Notes, plus accrued and unpaid interest to the date of the repurchase, payable in cash. Under GAAP, if an obligation is due on demand or will be due on demand within one year from the balance sheet date, even though liquidation may not be expected within that period, it should be classified as a current liability. Accordingly, the outstanding balance of Old Notes along with the deferred tax liability associated with accelerated interest deductions on the Old Notes will be classified as a current liability during the respective twelve month periods prior to June 4, 2012 and June 4, 2017. As of June 30, 2011, $169.1 million of the Old Notes and $57.9 million of deferred tax liabilities were classified as current liabilities in the Company s condensed consolidated balance sheets. The $57.9 million of deferred tax liabilities were included within current deferred tax assets, net. If all of the Old Notes are put back to the Company on June 4, 2012, the Company would be required to pay $169.1 million in outstanding principal, plus accrued interest. The Company would also be required to pay the accumulated deferred tax liability related to the Old Notes.

The Old Notes are convertible, at the holders option, prior to the maturity date into shares of the Company s Class A common stock in the following circumstances:

- during any quarter commencing after June 30, 2002, if the closing price of the Company s Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 110% of the conversion price of the Old Notes, or $31.96. The Old Notes are initially convertible at a conversion price of $29.05 per share, which is equal to a conversion rate of approximately 34.4234 shares per $1,000 principal amount of Old Notes, subject to adjustment;
- if the Company has called the Old Notes for redemption;
- during the five trading day period immediately following any nine consecutive day trading period in which the trading price of the Old Notes per $1,000 principal amount for each day of such period was less than 95% of the product of the closing sale price of the Company s Class A common stock on that day multiplied by the number of shares of the Company s Class A common stock issuable upon conversion of $1,000 principal amount of the Old Notes; or
- upon the occurrence of specified corporate transactions.

The Old Notes, which are unsecured, do not contain any restrictions on the payment of dividends, the incurrence of additional indebtedness or the repurchase of the Company s securities and do not contain any financial covenants.

The Company incurred $12.6 million of fees and other origination costs related to the issuance of the Old Notes. The Company amortized these costs over the first five-year Put period, which ran through June 4, 2007.

On August 14, 2003, the Company exchanged approximately $230.8 million in principal amount of its Old Notes for approximately $283.9 million in principal amount of its 1.5% Contingent Convertible Senior Notes Due 2033 (the New Notes). Holders of Old Notes that accepted the Company s exchange offer received $1,230 in principal amount of New Notes for each $1,000 in principal amount of Old Notes. The terms of the New Notes are similar to the terms of the Old Notes, but have a different interest rate, conversion rate and maturity date. Holders of Old Notes that chose not to exchange continue to be subject to the terms of the Old Notes.

The New Notes bear interest at a rate of 1.5% per annum, which is payable on June 4 and December 4 of each year, beginning December 4, 2003. The Company will also pay contingent interest at a rate of 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2008, if the average trading price of the New Notes reaches certain thresholds. No contingent interest related to the New Notes was payable at June 30, 2011 or December 31, 2010. The New Notes mature on June 4, 2033.

As a result of the exchange, the outstanding principal amounts of the Old Notes and the New Notes were $169.2 million and $283.9 million, respectively. The Company incurred approximately $5.1 million of fees and other origination costs related to the issuance of the New Notes. The Company amortized these costs over the first five-year Put period, which ran through June 4, 2008.

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Holders of the New Notes were able to require the Company to repurchase all or a portion of their New Notes on June 4, 2008, at 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash. Holders of approximately $283.7 million of New Notes elected to require the Company to repurchase their New Notes on June 4, 2008. The Company paid $283.7 million, plus accrued and unpaid interest of approximately $2.2 million, to the holders of New Notes that elected to require the Company to repurchase their New Notes. The Company was also required to pay an accumulated deferred tax liability of approximately $34.9 million related to the repurchased New Notes. This $34.9 million deferred tax liability was paid during the second half of 2008. Following the repurchase of these New Notes, $181,000 of principal amount of New Notes remained outstanding as of June 30, 2011 and December 31, 2010.

The remaining New Notes are convertible, at the holders option, prior to the maturity date into shares of the Company s Class A common stock in the following circumstances:

- during any quarter commencing after September 30, 2003, if the closing price of the Company s Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 120% of the conversion price of the New Notes, or $46.51. The Notes are initially convertible at a conversion price of $38.76 per share, which is equal to a conversion rate of approximately 25.7998 shares per $1,000 principal amount of New Notes, subject to adjustment;
- if the Company has called the New Notes for redemption;
- during the five trading day period immediately following any nine consecutive day trading period in which the trading price of the New Notes per $1,000 principal amount for each day of such period was less than 95% of the product of the closing sale price of the Company s Class A common stock on that day multiplied by the number of shares of the Company s Class A common stock issuable upon conversion of $1,000 principal amount of the New Notes; or
- upon the occurrence of specified corporate transactions.

The remaining New Notes, which are unsecured, do not contain any restrictions on the incurrence of additional indebtedness or the repurchase of the Company s securities and do not contain any financial covenants. The New Notes require an adjustment to the conversion price if the cumulative aggregate of all current and prior dividend increases above $0.025 per share would result in at least a one percent (1%) increase in the conversion price. This threshold has not been reached and no adjustment to the conversion price has been made.

During the quarter ended June 30, 2011, the Old Notes met the criteria for the right of conversion into shares of the Company s Class A common stock. This right of conversion of the holders of Old Notes was triggered by the stock closing above $31.96 on 20 of the last 30 trading days and the last trading day of the quarter ended June 30, 2011. The holders of Old Notes have this conversion right only until September 30, 2011. At the end of each future quarter, the conversion rights will be reassessed in accordance with the bond indenture agreement to determine if the conversion trigger rights have been achieved. During the quarter ended June 30, 2011, the New Notes did not meet the criteria for the right of conversion.

13. INCOME TAXES

Income taxes are determined using an annual effective tax rate, which generally differs from the U.S. Federal statutory rate, primarily because of state and local income taxes, enhanced charitable contribution deductions for inventory, tax credits available in the U.S., the treatment of certain share-based payments that are not designed to normally result in tax deductions, various expenses that are not deductible for tax purposes, changes in valuation allowances against deferred tax assets and differences in tax rates in certain non-U.S. jurisdictions. The Company s effective tax rate may be subject to fluctuations during the year as new information is obtained which may affect the assumptions it uses to estimate its annual effective tax rate, including factors such as its mix of pre-tax earnings in the various tax jurisdictions in which it operates, changes in valuation allowances against deferred tax assets, reserves for tax audit issues and settlements, utilization of tax credits and changes in tax laws in jurisdictions where the Company conducts operations. The Company recognizes tax benefits only if the tax position is more likely than not of being sustained. The Company recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of its assets and liabilities, along with net

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operating losses and credit carryforwards. The Company records valuation allowances against its deferred tax assets to reduce the net carrying value to amounts that management believes is more likely than not to be realized.

At June 30, 2011, the Company has an unrealized tax loss of $21.0 million related to the Company s option to acquire Revance or license Revance s topical product that is under development. The Company will not be able to determine the character of the loss until the Company exercises or fails to exercise its option. A realized loss characterized as a capital loss can only be utilized to offset capital gains. At June 30, 2011, the Company has recorded a valuation allowance of $7.6 million against the deferred tax asset associated with this unrealized tax loss in order to reduce the carrying value of the deferred tax asset to $0, which is the amount that management believes is more likely than not to be realized.

At June 30, 2011, the Company has an unrealized tax loss of $21.9 million related to the Company s option to acquire a privately-held U.S. biotechnology company. If the Company fails to exercise its option, a capital loss will be recognized. A loss characterized as a capital loss can only be used to offset capital gains. At June 30, 2011, the Company has recorded a valuation allowance of $7.9 million against the deferred tax asset associated with this unrealized tax loss in order to reduce the carrying value of the deferred tax asset to $0, which is the amount that management believes is more likely than not to be realized.

During the three months ended June 30, 2011 and June 30, 2010, the Company made net tax payments of $32.0 million and $30.9 million, respectively. During the six months ended June 30, 2011 and June 30, 2010, the Company made net tax payments of $38.0 million and $47.7 million, respectively.

The Company operates in multiple tax jurisdictions and is periodically subject to audit in these jurisdictions. These audits can involve complex issues that may require an extended period of time to resolve and may cover multiple years. The Company and its domestic subsidiaries file a consolidated U.S. federal income tax return. Such returns have either been audited or settled through statute expiration through 2006. The state of California conducted an examination on the Company s tax returns for the periods ending June 30, 2005, December 31, 2005, December 31, 2006 and December 31, 2007. During the three months ended March 31, 2011, the Company reached a settlement for all periods with the state of California and paid approximately $0.5 million. The state of California has also notified the Company of an upcoming examination of the Company s tax returns for the periods ending December 31, 2008 and December 31, 2009.

The Company owns two subsidiaries that file corporate tax returns in Sweden. The Swedish tax authorities examined the tax return of one of the subsidiaries for fiscal 2004. The examiners issued a no change letter, and the examination is complete. The Company s other subsidiary in Sweden has not been examined by the Swedish tax authorities. The Swedish statute of limitations may be open for up to five years from the date the tax return was filed. Thus, all returns filed for periods ending December 31, 2006 forward are open under the statute of limitations.

At June 30, 2011 and December 31, 2010, the Company had unrecognized tax benefits of $1.0 million and $1.4 million, respectively. The amount of unrecognized tax benefits which, if ultimately recognized, could favorably affect the Company s effective tax rate in a future period is $0.6 million and $0.9 million as of June 30, 2011 and December 31, 2010, respectively. During the next twelve months, the Company estimates that it is reasonably possible that the amount of unrecognized tax benefits will decrease by $0.7 million.

The Company recognizes accrued interest and penalties, if applicable, related to unrecognized tax benefits in income tax expense. The Company had approximately $0.5 million for the payment of interest and penalties accrued (net of tax benefit) at June 30, 2011 and December 31, 2010.

14. DIVIDENDS DECLARED ON COMMON STOCK

On June 8, 2011, the Company announced that its Board of Directors had declared a cash dividend of $0.08 per issued and outstanding share of the Company s Class A common stock, which was paid on July 29, 2011, to stockholders of record at the close of business on July 1, 2011. The $5.1 million dividend was recorded as a reduction of accumulated earnings and is included in other current liabilities in the accompanying condensed consolidated balance sheets as of June 30, 2011. The Company has not adopted a dividend policy.

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15. COMPREHENSIVE INCOME

Total comprehensive income includes net income and other comprehensive income (loss), which consists of foreign currency translation adjustments, unrealized gains and losses on available-for-sale investments and unamortized prior service costs related to the Company s supplemental executive retirement plan. Total comprehensive income for the three months ended June 30, 2011 and 2010, was $7.4 million and $36.9 million, respectively. Total comprehensive income for the six months ended June 30, 2011 and 2010, was $27.0 million and $72.9 million, respectively. Included as a reduction of total comprehensive income for the three and six months ended June 30, 2011 is $21.4 million related to the establishment of prior service costs related to the Company s supplemental executive retirement plan, net of income tax benefit.

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16. NET INCOME PER COMMON SHARE

The following table sets forth the computation of basic and diluted net income per common share (in thousands, except per share amounts):

	Three Months Ended					
	June 30, 2011			June 30, 2010		
	Continuing Operations	Discontinued Operations	Net Income	Continuing Operations	Discontinued Operations	Net Income
BASIC						
Net income (loss)	$ 34,512	$ (5,729)	$ 28,783	$ 40,928	$ (4,428)	$ 36,500
Less: income (loss) allocated to participating securities	1,113		916	1,355		1,206
Net income (loss) available to common stockholders	33,399	(5,729)	27,867	39,573	(4,428)	35,294
Weighted average number of common shares outstanding	60,308	60,308	60,308	58,271	58,271	58,271
Basic net income (loss) per common share	$ 0.55	$ (0.09)	$ 0.46	$ 0.68	$ (0.08)	$ 0.61
DILUTED						
Net income (loss)	$ 34,512	$ (5,729)	$ 28,783	$ 40,928	$ (4,428)	$ 36,500
Less: income (loss) allocated to participating securities	1,113		916	1,355		1,206
Net income (loss) available to common stockholders	33,399	(5,729)	27,867	39,573	(4,428)	35,294
Less: Undistributed earnings allocated to unvested stockholders	(987)		(796)	(1,263)		(1,113)
Add: Undistributed earnings re-allocated to unvested stockholders	971		783	1,256		1,107
Add: Tax-effected interest expense related to Old Notes	711		711	666		666
	$ 34,094	$ (5,729)	$ 28,565	$ 40,232	$ (4,428)	$ 35,954

Net income (loss) assuming dilution						
Weighted average number of common shares outstanding	60,308	60,308	60,308	58,271	58,271	58,271
Effect of dilutive securities:						
Old Notes	5,823		5,823	5,823		5,823
New Notes	4		4	4		4
Stock options	1,005		1,005	297		297
Weighted average number of common shares assuming dilution	67,140	60,308	67,140	64,395	58,271	64,395
Diluted net income (loss) per common share	$ 0.51	$ (0.09)	$ 0.43	$ 0.62	$ (0.08)	$ 0.56

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	Six Months Ended					
	June 30, 2011			June 30, 2010		
	Continuing Operations	Discontinued Operations	Net Income	Continuing Operations	Discontinued Operations	Net Income
BASIC						
Net income (loss)	$ 61,197	$ (13,054)	$ 48,143	$ 80,946	$ (9,078)	$ 71,868
Less: income (loss) allocated to participating securities	1,905		1,469	2,673		2,368
Net income (loss) available to common stockholders	59,292	(13,054)	46,674	78,273	(9,078)	69,500
Weighted average number of common shares outstanding	59,719	59,719	59,719	58,161	58,161	58,161
Basic net income (loss) per common share	$ 0.99	$ (0.22)	$ 0.78	$ 1.35	$ (0.16)	$ 1.19
DILUTED						
Net income (loss)	$ 61,197	$ (13,054)	$ 48,143	$ 80,946	$ (9,078)	$ 71,868
Less: income (loss) allocated to participating securities	1,905		1,469	2,673		2,368
Net income (loss) available to common stockholders	59,292	(13,054)	46,674	78,273	(9,078)	69,500
Less: Undistributed earnings allocated to unvested stockholders	(1,668)		(1,245)	(2,474)		(2,170)
Add: Undistributed earnings re-allocated to unvested stockholders	1,647		1,229	2,461		2,159
Add: Tax-effected interest expense related to Old Notes	1,376		1,376	1,332		1,332
Tax-effected interest expense related to New Notes	1		1	1		1
	$ 60,648	$ (13,054)	$ 48,035	$ 79,593	$ (9,078)	$ 70,822

Net income (loss) assuming dilution						
Weighted average number of common shares outstanding	59,719	59,719	59,719	58,161	58,161	58,161
Effect of dilutive securities:						
Old Notes	5,823		5,823	5,823		5,823
New Notes	4		4	4		4
Stock options	801		801	306		306
Weighted average number of common shares assuming dilution	66,347	59,719	66,347	64,294	58,161	64,294
Diluted net income (loss) per common share	$ 0.91	$ (0.22)	$ 0.72	$ 1.24	$ (0.16)	$ 1.10

Diluted net income per common share must be calculated using the if-converted method. Diluted net income per share using the if-converted method is calculated by adjusting net income for tax-effected net interest on the Old Notes and New Notes, divided by the weighted average number of common shares outstanding assuming conversion.

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Unvested share-based payment awards that contain rights to receive nonforfeitable dividends or dividend equivalents (whether paid or unpaid) are participating securities, and thus, are included in the two-class method of computing earnings per share. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that would otherwise have been available to common stockholders. Restricted stock granted to certain employees by the Company (see Note 3) participate in dividends on the same basis as common shares, and these dividends are not forfeitable by the holders of the restricted stock. As a result, the restricted stock grants meet the definition of a participating security.

The diluted net income per common share computation for the three months ended June 30, 2011 and 2010 excludes 1,797,876 and 8,027,204 shares of stock, respectively, that represented outstanding stock options whose impact would be anti-dilutive. The diluted net income per common share computation for the six months ended June 30, 2011 and 2010 excludes 3,291,806 and 8,559,315 shares of stock, respectively, that represented outstanding stock options whose impact would be anti-dilutive.

Due to the net loss from discontinued operations during the three and six months ended June 30, 2011 and 2010, diluted earnings per share and basic earnings per share from discontinued operations are the same, as the effect of potentially dilutive securities would be anti-dilutive.

17. COMMITMENTS AND CONTINGENCIES

Legal Matters

The Company is currently party to various legal proceedings, including those noted in this section. Unless specifically noted below, any possible range of loss associated with the legal proceedings described below is not reasonably estimable at this time. The Company is engaged in numerous other legal actions not described below arising in the ordinary course of its business and, while there can be no assurance, the Company believes that the ultimate outcome of these actions will not have a material adverse effect on its operating results, liquidity or financial position.

From time to time the Company may conclude it is in the best interests of its stockholders, employees, and customers to settle one or more litigation matters, and any such settlement could include substantial payments; however, other than as noted below, the Company has not reached this conclusion with respect to any particular matter at this time. There are a variety of factors that influence the Company s decisions to settle and the amount the Company may choose to pay, including the strength of its case, developments in the litigation, the behavior of other interested parties, the demand on management time and the possible distraction of the Company s employees associated with the case and/or the possibility that the Company may be subject to an injunction or other equitable remedy. It is difficult to predict whether a settlement is possible, the amount of an appropriate settlement or when is the opportune time to settle a matter in light of the numerous factors that go into the settlement decision. Unless otherwise specified below, any settlement payment made pursuant to any of the completed settlement agreements described below is immaterial to the Company for financial reporting purposes.

Stockholder Class Action Litigation

On October 3, 10 and 27, 2008, purported stockholder class action lawsuits styled Andrew Hall v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01821-MHB); Steamfitters Local 449 Pension Fund v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01870-DKD); and Darlene Oliver v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01964-JAT) were filed in the United States District Court for the District of Arizona on behalf of stockholders who purchased securities of the Company during the period between October 30, 2003 and approximately September 24, 2008. The Court consolidated these actions into a single proceeding and on May 18, 2009 an amended complaint was filed alleging violations of the federal securities laws arising out of the Company s restatement of its consolidated financial statements in 2008. On December 2, 2009, the Court granted the Company s and other defendants dismissal motions and dismissed the consolidated amended complaint without prejudice. On January 18, 2010 the lead plaintiff filed a second amended complaint, and on or about August 9, 2010, the Court denied the Company s and other defendants related dismissal motions. On December 17, 2010, the lead plaintiff filed a motion for class certification, and the defendants filed an opposition to the motion on March 8, 2011. On June 6, 2011, the Company, certain of its current officers who are named in the complaint, and the Company s outside auditors entered into a Memorandum of Understanding (the Class Action MOU) with the

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plaintiffs representatives to memorialize an agreement in principle to settle the pending action. Under the terms of the settlement agreement, which remains subject to Court approval among other customary conditions, the Company s portion of the settlement will be paid entirely by insurance. The Company s outside auditors also will contribute to this settlement. The Company itself is not required to make any payments to fund the settlement. The settlement agreement contains no admission of liability by the Company or the named individuals in the action, the allegations of which are expressly denied in the Class Action MOU. In the event the settlement is not approved by the Court, the Company will continue to vigorously defend the claims in the class action lawsuits. There can be no assurance that the Court will approve the settlement, or that the Company will otherwise ultimately be successful in settling the lawsuits or in defending the lawsuits, and an adverse resolution of the lawsuits could have a material adverse effect on the Company s financial position and results of operations in the period in which the lawsuits are resolved.

Stockholder Derivative Lawsuits

On January 21, 2009, the Company received a letter from an alleged stockholder demanding that its Board of Directors take certain actions, including potentially legal action, in connection with the restatement of its consolidated financial statements in 2008. The letter stated that, if the Board of Directors did not take the demanded action, the alleged stockholder would commence a derivative action on behalf of the Company. The Company s Board of Directors reviewed the letter during the course of 2009 and established a special committee of the Board of Directors, comprised of directors who are independent and disinterested with respect to the allegations in the letter, to assess the allegations contained in the letter. The special committee engaged outside counsel to assist with the investigation. The special committee completed its investigation, and on or about February 16, 2010, the Board of Directors, pursuant to the report and recommendation of the special committee, resolved to decline the derivative demand. On February 26, 2010, Company counsel sent a declination letter to opposing counsel. On or about October 21, 2010, the stockholder filed a derivative complaint against the Company and its directors and certain officers in the Superior Court of the State of Arizona in and for the County of Maricopa, alleging that such individuals breached their fiduciary duties to the Company in connection with the restatement. The stockholder seeks to recover unspecified damages and costs, including counsel and expert fees.

On or about October 20, 2010, a second alleged stockholder of the Company filed a derivative complaint against the Company and its directors and certain officers in the Superior Court of the State of Arizona in and for the County of Maricopa. The complaint alleges, among other things, that such individuals breached their fiduciary duties to the Company in connection with the restatement. The complaint further alleges that a demand upon the Board of Directors to institute an action in the Company s name would be futile and that the stockholder is therefore excused under Delaware law from making such a demand prior to filing the complaint. The stockholder seeks, among other things, to recover unspecified damages and costs, including counsel and expert fees.

On June 6, 2011, the Company and certain of its current officers and directors who are named in the complaints entered into a Memorandum of Understanding (the Derivative Lawsuits MOU) with the plaintiffs representatives to memorialize an agreement in principle to settle the pending actions. The only financial component under the settlement agreement, which remains subject to Court approval among other customary conditions, involves payment of plaintiffs attorneys fees, which will be paid entirely by insurance. The Company itself is not required to make any payments to fund the settlement. The settlement also reflects certain control and other enhancements taken by the Company in connection with and subsequent to the restatement of its consolidated financial statements in 2008. The settlement agreement contains no admission of liability by the Company or the named individuals in the lawsuits, the allegations of which are expressly denied in the Derivative Lawsuits MOU. In the event the settlement is not approved by the Court, the Company will continue to vigorously defend the claims in the derivative lawsuits. There can be no assurance that the Court will approve the settlement, or that the Company will otherwise ultimately be successful in settling the lawsuits or in defending the lawsuits, and an adverse resolution of the lawsuits could have a material adverse effect on the Company s financial position and results of operations in the period in which the lawsuits are resolved.

Hyperion Arbitration

On June 23, 2011, Hyperion Therapeutics, Inc. (Hyperion) filed a demand for arbitration before the American Arbitration Association for a judgment declaration of the rights and obligations of Hyperion and Ucyclyd Pharma,

Inc., a subsidiary of the Company (Ucyclyd), under a collaboration agreement between the parties, dated August 23, 2007, as amended (the Collaboration Agreement). Pursuant to the terms of the Collaboration

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Agreement, Hyperion is responsible for the ongoing research and development of a compound referred to as HPN-100 (formerly known as GT4P) for the treatment of urea cycle disorder, hepatic encephalopathies and other indications. In addition, if certain specified conditions are satisfied, then Hyperion will have certain purchase rights under the Collaboration Agreement with respect to HPN-100, as well as Ucyclyd s existing on-market products, AMMONUL® and BUPHENYL®, and will be required to pay Ucyclyd royalties and regulatory and sales milestone payments in connection with certain licenses that will be granted to Hyperion upon exercise of the purchase rights. In its demand for arbitration, Hyperion requested a judgment regarding the rights of the parties in connection with the development activities relating to HPN-100, including relating to the submission of a NDA to the FDA for HPN-100 for the treatment of urea cycle disorder. The Company responded to the demand for arbitration on July 28, 2011. In its response, the Company denied the allegations of Hyperion and requested the arbitration panel deny Hyperion s requested declaratory relief. Additionally, the Company brought counterclaims against Hyperion and sought a declaration of rights in the Company s favor and an award of damages.

In addition to the matters discussed above, in the ordinary course of business, the Company is involved in a number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. Although the outcome of these actions is not presently determinable, it is the opinion of the Company s management, based upon the information available at this time, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the results of operations, financial condition or cash flows of the Company.

18. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards* (Topic 820) *Fair Value Measurement*, to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU No. 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, particularly for level 3 fair value measurements. ASU No. 2011-04 is effective for interim and annual reporting periods beginning after December 15, 2011 and must be applied prospectively. The Company is currently assessing what impact, if any, the revised guidance will have on its results of operations and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income* (Topic 220): *Presentation of Comprehensive Income*. The updated guidance amends the FASB Accounting Standards Codification (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both alternatives, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. The amendments to the Codification in the ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU No. 2011-05 will be applied retrospectively. ASU No. 2011-05 is effective for annual reporting periods beginning after December 15, 2011, with early adoption permitted, and will be applied retrospectively. It is expected that the adoption of this amendment will only impact the presentation of comprehensive income within the Company s consolidated financial statements.

19. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through the date of issuance of its financial statements.

License and Settlement Agreement with Lupin

On July 21, 2011, the Company entered into a License and Settlement Agreement (the Settlement Agreement) with Lupin Limited and Lupin Pharmaceuticals, Inc. (together, Lupin). Under the terms of the Settlement Agreement, the Company agreed to grant to Lupin a future license to make and sell its generic versions of SOLODYN® in 45mg, 90mg and 135mg strengths under the SOLODYN® intellectual property rights belonging to the Company, with the

license grant effective November 26, 2011, or earlier under certain conditions. The

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Company also agreed to grant to Lupin future licenses to make and sell its generic versions of SOLODYN® in 65mg and 115mg strengths effective in February 2018, or earlier under certain conditions, and its generic versions of SOLODYN® in 55mg (against which Lupin s Paragraph IV Patent Certification was the first received by the Company), 80mg and 105mg strengths effective in February 2019, or earlier under certain conditions. The Settlement Agreement provides that Lupin will be required to pay the Company royalties based on sales of Lupin s generic SOLODYN® products pursuant to the foregoing licenses.

Pursuant to the Settlement Agreement, the companies agreed to terminate all legal disputes between them relating to SOLODYN®. In addition, Lupin confirmed that the Company s patents relating to SOLODYN® are valid and enforceable, and cover Lupin s activities relating to Lupin s generic SOLODYN® products under an ANDA. Lupin also agreed to be permanently enjoined from any distribution of generic SOLODYN® products in the U.S. except as described above.

On July 21, 2011, the Company entered into a Joint Development Agreement (the Joint Development Agreement) with Lupin Limited, on behalf of itself and its affiliates (hereinafter collectively referred to in this paragraph as Lupin), whereby the Company and Lupin will collaborate to develop multiple novel proprietary therapeutic products. Pursuant to the Joint Development Agreement, subject to the terms and conditions contained therein, the Company will make an up-front $20 million payment to Lupin and will make additional payments to Lupin of up to $38 million upon the achievement of certain research, development, regulatory and other milestones, as well as royalty payments on sales of the products covered under the agreement. In addition, the Company will receive an exclusive, worldwide (excluding India) license on the sale of the products covered under the Joint Development Agreement. The $20 million up-front payment will be recognized as research and development expense during the three months ended September 30, 2011.

Stock Repurchase Plan

On August 8, 2011, the Company announced that its Board of Directors approved a Stock Repurchase Plan to purchase up to $200 million in aggregate value of shares of Medicis Class A common stock. Any repurchases will be made in compliance with the Securities and Exchange Commission s Rule 10b-18.

The number of shares to be repurchased and the timing of repurchases (if any) will depend on a variety of factors, including, but not limited to, stock price, economic and market conditions and corporate and regulatory requirements. The plan does not obligate the Company to repurchase any common stock. The plan is scheduled to terminate on the earlier of the first anniversary of the plan or the time at which the purchase limit is reached, but may be suspended or terminated at any time at the Company s discretion without prior notice.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Executive Summary

We are a leading independent specialty pharmaceutical company focused primarily on helping patients attain a healthy and youthful appearance and self-image through the development and marketing in the U.S. of products for the treatment of dermatological and aesthetic conditions. We also market products in Canada for the treatment of dermatological and aesthetic conditions and began commercial efforts in Europe with our acquisition of LipoSonix in July 2008. We offer a broad range of products addressing various conditions or aesthetics improvements, including facial wrinkles, acne, fungal infections, hyperpigmentation, photoaging, psoriasis, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin).

Our current product lines 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 urea cycle disorder and contract revenue. Our acne and acne-related dermatological product lines include SOLODYN® and ZIANA®. During early 2011, we discontinued our TRIAZ® branded products and decided to no longer promote our PLEXION® branded products. Our non-acne dermatological product lines include DYSPORT®, LOPROX®, PERLANE®, RESTYLANE® and VANOS®. Our non-dermatological product lines include AMMONUL® and BUPHENYL®. Our non-dermatological field also includes contract revenues associated with licensing agreements and authorized generic agreements.

Financial Information About Segments

We operate in one business segment: pharmaceuticals. Our current pharmaceutical franchises are divided between the dermatological and non-dermatological fields. Information on revenues, operating income, identifiable assets and supplemental revenue of our business franchises appears in the condensed consolidated financial statements included in Item 1 hereof.

Key Aspects of Our Business

We derive a majority of our revenue from our primary products: DYSPORT®, PERLANE®, RESTYLANE®, SOLODYN®, VANOS® and ZIANA®. We believe that sales of our primary products will constitute a significant portion of our revenue for 2011.

We have built our business by executing a four-part growth strategy: promoting existing brands, developing new products and important product line extensions, entering into strategic collaborations and acquiring complementary products, technologies and businesses. Our core philosophy is to cultivate high integrity relationships of trust and confidence with the foremost dermatologists and the leading plastic surgeons in the U.S. We rely on third parties to manufacture our products (except for the LIPOSONIX™ system).

We estimate customer demand for our prescription products primarily through use of third party syndicated data sources which track prescriptions written by health care providers and dispensed by licensed pharmacies. The data represents extrapolations from information provided only by certain pharmacies and are estimates of historical demand levels. We estimate customer demand for our non-prescription products primarily through internal data that we compile. We observe trends from these data and, coupled with certain proprietary information, prepare demand forecasts that are the basis for purchase orders for finished and component inventory from our third party manufacturers and suppliers. Our forecasts may fail to accurately anticipate ultimate customer demand for our products. Overestimates of demand and sudden changes in market conditions may result in excessive inventory production and underestimates may result in inadequate supply of our products in channels of distribution.

We schedule our inventory purchases to meet anticipated customer demand. As a result, miscalculation of customer demand or relatively small delays in our receipt of manufactured products could result in revenues being deferred or lost. Our operating expenses are based upon anticipated sales levels, and a high percentage of our operating expenses are relatively fixed in the short term.

We sell our products primarily to major wholesalers and retail pharmacy chains. Approximately 75-80% of our gross revenues are typically derived from two major drug wholesale concerns. Depending on the customer, we recognize revenue at the time of shipment to the customer, or at the time of receipt by the customer, net of estimated

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provisions. We recognize revenue on our aesthetics products DYSPORT®, PERLANE® and RESTYLANE® upon shipment from McKesson, our exclusive U.S. distributor of these products, to physicians. Consequently, variations in the timing of revenue recognition could cause significant fluctuations in operating results from period to period and may result in unanticipated periodic earnings shortfalls or losses. We have distribution services agreements with our two largest wholesale customers. We review the supply levels of our significant products sold to major wholesalers by reviewing periodic inventory reports that are supplied to us by our major wholesalers in accordance with the distribution services agreements. We rely wholly upon our wholesale and retail chain drugstore customers to effect the distribution allocation of substantially all of our prescription products. We believe our estimates of trade inventory levels of our products, based on our review of the periodic inventory reports supplied by our major wholesalers and the estimated demand for our products based on prescription and other data, are reasonable. We further believe that inventories of our products among wholesale customers, taken as a whole, are similar to those of other specialty pharmaceutical companies, and that our trade practices, which periodically involve volume discounts and early payment discounts, are typical of the industry.

We periodically offer promotions to wholesale and retail chain drugstore customers to encourage dispensing of our prescription products, consistent with prescriptions written by licensed health care providers. Because many of our prescription products compete in multi-source markets, it is important for us to ensure the licensed health care providers dispensing instructions are fulfilled with our branded products and are not substituted with a generic product or another therapeutic alternative product which may be contrary to the licensed health care providers recommended and prescribed Medicis brand. We believe that a critical component of our brand protection program is maintenance of full product availability at wholesale and drugstore customers. We believe such availability reduces the probability of local and regional product substitutions, shortages and backorders, which could result in lost sales. We expect to continue providing favorable terms to wholesale and retail chain drugstore customers as may be necessary to ensure the fullest possible distribution of our branded products within the pharmaceutical chain of commerce. From time to time we may enter into business arrangements (e.g., loans or investments) involving our customers and those arrangements may be reviewed by federal and state regulators.

Purchases by any given customer, during any given period, may be above or below actual prescription volumes of any of our products during the same period, resulting in fluctuations of product inventory in the distribution channel. In addition, we consistently assess our product mix and portfolio to promote a high level of profitability and revenues and to ensure that our products are responsive to consumer tastes and changes to regulatory classifications. During early 2011, we discontinued our TRIAZ® branded products and decided to no longer promote our PLEXION® branded products.

Recent Developments

As described in more detail below, the following significant events and transactions occurred during the six months ended June 30, 2011, and affected our results of operations, our cash flows and our financial condition:

Research and development agreement with Anacor;

Settlement Agreement with Teva;

Classification of LipoSonix as a discontinued operation;

Increase of our quarterly dividend from $0.06 per share to $0.08 per share;

Development milestone payment related to our collaboration with a privately-held U.S. biotechnology company;

Issuance of new patent covering SOLODYN®;

Settlement of class action and derivative lawsuits; and

Establishment of a Supplemental Executive Retirement Plan.

Research and development agreement with Anacor

On February 9, 2011, we entered into a research and development agreement with Anacor Pharmaceuticals, Inc. (Anacor) for the discovery and development of boron-based small molecule compounds directed against a target for the potential treatment of acne. Under the terms of the agreement, we paid Anacor $7.0 million in connection with the execution of the agreement, and will pay up to $153.0 million upon the achievement of certain research, development, regulatory and commercial milestones, as well as royalties on sales by us. Anacor will be responsible for discovering and conducting the early development of product candidates which utilize Anacor s proprietary boron chemistry platform, while we will have an option to obtain an exclusive license for products

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covered by the agreement. The initial $7.0 million payment was recognized as research and development expense during the three months ended March 31, 2011.

Settlement Agreement with Teva

On February 24, 2011, we entered into a Settlement Agreement (Teva Settlement Agreement) with Barr Laboratories, Inc., a subsidiary of Teva Pharmaceuticals USA, Inc., on behalf of itself and certain of its affiliates, including Teva Pharmaceuticals USA, Inc. (collectively, Teva). Under the terms of the Teva Settlement Agreement, we agreed to grant to Teva a future license to make and sell our generic versions of SOLODYN® in 65mg and 115mg strengths under the SOLODYN® intellectual property rights belonging to us, with the license grant effective in February 2018, or earlier under certain conditions. We also agreed to grant to Teva a future license to make and sell generic versions of SOLODYN® in 55mg, 80mg and 105mg strengths under our SOLODYN® intellectual property rights, with the license grant effective in February 2019, or earlier under certain conditions. The Teva Settlement Agreement provides that Teva will be required to pay us royalties based on sales of Teva s generic SOLODYN® products pursuant to the foregoing licenses. Pursuant to the Teva Settlement Agreement, the companies agreed to terminate all legal disputes between them relating to SOLODYN®. In addition, Teva confirmed that our patents relating to SOLODYN® are valid and enforceable, and cover Teva s activities relating to Teva s generic SOLODYN® products under ANDA No. 65-485 and any amendments and supplements thereto. Teva also agreed to be permanently enjoined from any distribution of generic SOLODYN® products in the U.S. except as described above. The United States District Court for the District of Maryland subsequently entered a permanent injunction against any infringement by Teva.

Classification of LipoSonix as a discontinued operation

On February 25, 2011, we announced that as a result of our strategic planning process and the current regulatory and commercial capital equipment environment, we determined to explore strategic alternatives for our LipoSonix business including, but not limited to, the sale of the stand-alone business. We have engaged Deutsche Bank to assist us in our exploration of strategic alternatives for LipoSonix. As a result of this decision, we now classify the LipoSonix business as a discontinued operation for financial statement reporting purposes.

Increase of our quarterly dividend from $0.06 per share to $0.08 per share

On March 22, 2011, we announced that our Board of Directors had declared a cash dividend of $0.08 per issued and outstanding share of our Class A common stock, which was paid on April 29, 2011, to stockholders of record at the close of business on April 1, 2011. This represented a 33% increase compared to our previous $0.06 dividend. A subsequent cash dividend announced in June 2011 was also at the rate of $0.08 per issued and outstanding share of our Class A common stock. The dividend was paid on July 29, 2011 to stockholders of record at the close of business on July 1, 2011.

Development milestone payment related to our collaboration with a privately-held U.S. biotechnology company

On September 10, 2010, we and a privately-held U.S. biotechnology company entered into a sublicense and development agreement to develop an agent for specific dermatological conditions in the Americas and Europe and a purchase option to acquire the privately-held U.S. biotechnology company. Under the terms of the agreements, we paid the privately-held U.S. biotechnology company $5.0 million in connection with the execution of the agreement, and will pay additional potential milestone payments totaling approximately $100.5 million upon successful completion of certain clinical, regulatory and commercial milestones.

During the three months ended June 30, 2011, a development milestone was achieved, and we made a $5.5 million payment pursuant to the agreements. The $5.5 million milestone payment was recognized as research and development expense during the three months ended June 30, 2011.

Issuance of new patent covering SOLODYN®

On April 5, 2011, the United States Patent and Trademark Office (USPTO) issued U.S. Patent No. 7,919,483, entitled Method For The Treatment Of Acne (the 483 Patent) to us. The 483 Patent, which expires in February 2027, covers methods of using a controlled-release oral dosage form of minocycline to treat acne, including the use of our product SOLODYN® in all eight currently available dosage forms. As previously reported,

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the USPTO issued a Notice of Allowance for U.S. Application No. 11/166,817, the patent application for the 483 Patent, in October 2009 and a second Notice of Allowance in April 2010 following the completion of a Request for Continued Examination which we filed with the USPTO in November 2009.

Settlement of class action and derivative lawsuits

On June 6, 2011, we, certain of our current officers and directors named in the class action and derivative lawsuits more fully described under Legal Matters in Note 17 in the notes to the condensed consolidated financial statements, included in Part I, Item I of this Report, and our outside auditors entered into Memoranda of Understanding (the MOUs) with the plaintiffs representatives to memorialize an agreement in principle to settle the class action, as well as both stockholder derivative lawsuits. Under the terms of these settlement agreements, which remain subject to approval by the applicable courts among other customary conditions, our portion of the class action settlement will be paid entirely by insurance. Our outside auditors also will contribute to this settlement. The derivative lawsuits settlement, the only financial component of which involves payment of plaintiffs attorneys fees, also will be paid entirely by insurance. We are not required to make any payments to fund the settlements of the class action or the derivative lawsuits. The settlement of the derivative lawsuits reflects certain control and other enhancements undertaken by us in connection with and subsequent to the restatement of our consolidated financial statements in 2008. The settlement agreements contain no admission of liability by us or the named individuals in the respective actions, the allegations of which are expressly denied in the MOUs.

Establish