MEDICIS PHARMACEUTICAL CORP
Form 10-K
September 28, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2001.
Or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to _____.

Commission file number 0-18443

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	52-1574808
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8125 North Hayden Road, Scottsdale, Arizona	85258-2463
(Address of principal executive office)	(Zip Code)

Registrant s telephone number, including area code: (602) 808-8800

Securities registered pursuant to Section 12(b) of the Act: Class A Common Stock, $0.014 par value
Preference Share Purchase Rights

(Title of each Class)

Securities registered pursuant to Section 12(g) of the Act: NONE

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form or any amendment to this Form 10-K [ ].

The aggregate market value of the voting stock held on September 20, 2001 by non-affiliates of the registrant was $1,026,575,610 (calculated by excluding all shares held by executive officers, directors and holders known to the registrant of five percent or more of the voting power of the registrant s Common Stock, without conceding that such persons are affiliates of the Registrant for purposes of the federal securities laws). As of September 20, 2001, there were 30,165,251 outstanding shares of Class A Common Stock $0.014 par value and 422,962 shares of Class B Common Stock $0.014 par value.

Documents incorporated by reference:

Portions of the Proxy Statement for the Registrant s 2001 Annual Meeting of Shareholders are incorporated herein by reference in Part III of this Form 10-K to the extent stated herein.

PART I

ITEM 1: BUSINESS

Medicis Pharmaceutical Corporation (Medicis or The Company) is a specialty pharmaceutical company and the leading independent pharmaceutical company in the United States focusing primarily on the treatment of dermatological conditions. Medicis offers prescription products and an over-the-counter (OTC) product, emphasizing the clinical effectiveness, quality, affordability and cosmetic elegance of its products. Medicis develops and markets leading products for major segments within dermatology, including acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, eczema, skin and skin-structure infections, seborrheic dermatitis, head lice and cosmesis (improvement in the texture and appearance of skin). Medicis has built its business by successfully executing a four-part growth strategy. The Company s growth strategy includes: (1) expanding sales of existing brands; (2) launching new products from research and development efforts; (3) acquiring complementary strategic products, businesses and technologies; and (4) collaborating with other companies.

Medicis derives a majority of its revenue from sales of its DYNACIN®, LOPROX®, LUSTRA®, LUSTRA-AF®, and ALUSTRA , PLEXION and PLEXION TS , TRIAZ®, OVIDE® and BUPHENYL® products (the Key Products).

PRINCIPAL PRODUCTS AND PRODUCT LINES

The Company s primary products include the prescription brands DYNACIN® (minocycline HCl), LOPROX® (ciclopirox), LUSTRA®, LUSTRA-AF® and ALUSTRA (hydroquinone), PLEXION and PLEXION TS (sodium sulfacetamide/sulfur), TRIAZ® (benzoyl peroxide), OVIDE® (malathion) and BUPHENYL® (sodium phenylbutyrate), a prescription product indicated in the treatment of Urea Cycle Disorder, and the over-the-counter brand ESOTERICA®.

PRESCRIPTION PHARMACEUTICALS

Medicis focuses its pharmaceutical sales efforts on prescription products for the treatment of acne, acne-related conditions, rosacea, fungal infections, psoriasis, seborrheic dermatitis, hyperpigmentation and photodamaged skin, including the appearance of fine lines and wrinkles. The Company s principal branded pharmaceutical products are described below.

DYNACIN® is an oral, systemic antibiotic, available in 50-mg., 75-mg. and 100-mg. dosage forms, and is prescribed for the treatment of moderate to severe acne. DYNACIN® is the number one brand of minocycline prescribed for the treatment of moderate to severe acne. The most commonly prescribed systemic acne treatments are tetracycline and its derivatives, minocycline and doxycycline. Minocycline, the active ingredient in DYNACIN®, is widely prescribed for the treatment of acne for several reasons. It has a more convenient schedule of one or two doses per day as compared to other forms of tetracycline, which can require up to four doses per day. Other forms of tetracycline require ingestion on an empty stomach and may increase patient sensitivity to sunlight, creating a greater risk of sunburn. Moreover, the other forms of tetracycline, including doxycycline, have been reported to often cause gastric irritation. In addition, resistance to several commonly used antibiotics, including erythromycin, clindamycin, doxycycline and tetracycline, by the primary bacterial organism responsible for acne has been documented. Studies suggest that bacterial resistance to erythromycin, doxycycline and tetracycline exceeds 50%, while the bacteria showed virtually no resistance to minocycline. The Company believes the retail price of DYNACIN® products is approximately 30% lower than the average reported retail price of a competing branded minocycline product, Minocin®, while selling at a price higher than the average reported retail price of generic minocycline. DYNACIN® was launched in the second quarter of the fiscal year ended June 30, 1993 with 50-mg. and 100-mg. dosage forms available. The Company launched DYNACIN® in 75-mg. dosage form in the fourth quarter of the fiscal year ended June 30, 1999 (fiscal 1999). The Company has a manufacturing and supply agreement with Watson Pharmaceuticals, Inc. (Watson) as successor-in-interest to Schein Pharmaceutical, Inc. (Schein) for the supply of DYNACIN®. Watson acquired Schein in August 2000.

< P> **LOPROX**® cream 0.77% and lotion 0.77% are both broad-spectrum prescription antifungal agents indicated for the topical treatment of tinea pedis, tinea corporis, tinea cruris, tinea versicolor and cutaneous candidiasis. In the second quarter of the fiscal year ended June 30, 2000 (fiscal 2000), the Company received FDA approval to market LOPROX® Gel (0.77% ciclopirox) for the treatment of seborrheic dermatitis and fungal infections. Currently, LOPROX® Gel is the only gel approved in the United States for seborrheic dermatitis. Currently, LOPROX® is the only hydroxypyridone antifungal agent available in the United States. LOPROX® works with a unique mode of action that has been shown to have fungistatic and fungicidal properties and enhanced penetration. The Company believes this unique mode of action

makes LOPROX® an appropriate choice for topical treatment alone, or as concomitant treatment with an oral antifungal. For these reasons, the Company believes LOPROX® may be a better product to manage the often-complicated mix of organisms involved in tinea infections. In clinical trials, LOPROX® was shown to produce clinical improvement of 82% to 93% of subjects after a single week of treatment across the range of cutaneous mycoses. The Company believes it is among the lowest priced branded prescription topical antifungals. The United States market for topical antifungal pharmaceuticals reached nearly $600 million in 2000. The overall market for antifungals in the United States is approximately $1.7 billion annually. The most frequently prescribed topical antifungal products in addition to LOPROX® include Spectazole®, Nizoral®, Oxistat® and Lotrisone® (steroid/antifungal combination). LOPROX® was licensed from Aventis Pharma (Aventis) as successor-in-interest to Hoechst Marion Roussell (HMR) in November 1998 and re-launched by Medicis in the third quarter of fiscal 1999. LOPROX® products are manufactured to the Company s specifications and supplied under an agreement with Aventis.

LUSTRA®, **LUSTRA-AF®** and **ALUSTRA** are internally developed, patented, topical therapies prescribed for the treatment of ultra-violet induced skin discolorations and hyperpigmentation usually associated with the use of oral contraceptives, pregnancy, hormone replacement therapy, sun damage and superficial trauma. LUSTRA®, LUSTRA-AF® and ALUSTRA contain 4% hydroquinone in a patented vehicle containing glycolic acid in an anti-oxidant complex. LUSTRA® is second in market share only to LUSTRA-AF®, the leading prescription topical treatment for dyschromia and hyperpigmentation. In controlled clinical trials sponsored by the Company in 1998, LUSTRA® demonstrated a reduction in pigmented lesions in a two-week period with statistically significant performance over the competing brands Solaquin Forte® and Melanex®. The Company started shipping LUSTRA® to wholesalers in February 1998. LUSTRA-AF® contains broad-spectrum UVA and UVB sunscreen agents and was introduced to the market in the fourth quarter of fiscal 1999. ALUSTRA contains retinol and was announced to the market in the fourth quarter of the fiscal year ended June 30, 2001 (fiscal 2001). LUSTRA®, LUSTRA-AF® and ALUSTRA are manufactured in accordance with a manufacturing agreement with Contract Pharmaceuticals, Limited (Contract Pharmaceuticals).

PLEXION and **PLEXION TS** are internally developed, patent pending, cleanser and topical therapies for the treatment of rosacea and acne-related conditions. Rosacea is a chronic skin condition causing inflammation and redness of the face usually on the nose and cheeks and occasionally on the chin and forehead. Rosacea affects about 13 million Americans each year and typically affects fair-skinned adults between the ages of 30 and 50. PLEXION is appropriate for this population and is designed to be used in conjunction with other prescription rosacea therapies. The active ingredients in PLEXION and PLEXION TS are sodium sulfacetamide and sulfur. Sales of products to treat rosacea in the United States in 2000 were nearly $292 million. PLEXION , the first and only prescription cleanser indicated for the treatment of rosacea, was launched by Medicis in the fourth quarter of fiscal 2000 and is available in 6- and 12-ounce sizes. The topical acne rosacea market is comprised of products such as MetroGel®, MetroCream® and MetroLotion®. PLEXION TS , a gentle topical suspension treatment for comedonal acne, was launched by Medicis in the fourth quarter of fiscal 2001. The Company believes PLEXION and PLEXION TS are priced comparably to competing brands. The Company has a manufacturing and supply agreement with Contract Pharmaceuticals for the production of PLEXION and PLEXION TS .

TRIAZ® is an internally developed, patented, topical therapy prescribed for the treatment of all forms and varying degrees of acne, and is available as a gel or cleanser in three concentrations. The combined sales of topically applied prescription acne products were estimated to be over $1 billion in the United States in 2000. TRIAZ® is currently the leading branded prescription benzoyl peroxide product in dermatology. While other topical acne treatments, including Cleocin-T® and Benzamycin®, are generally effective, TRIAZ® offers advantages over each product, including improved stability, greater convenience of use, reduced cost and fewer side effects. The Company

believes the average reported retail price of TRIAZ® is less than that of either Cleocin-T® or Benzamycin®. TRIAZ® products are manufactured using the active ingredient benzoyl peroxide in a patented vehicle containing glycolic acid and zinc lactate. Studies conducted by third parties have shown that benzoyl peroxide is the most efficacious agent available for eradicating the bacteria that cause acne with no reported resistance. Glycolic acid is believed by the Company to enhance the effectiveness of benzoyl peroxide by exfoliating the outer layer of the skin and zinc lactate is believed by the Company to act to reduce the appearance of inflammation and irritation often associated with acne. TRIAZ® was developed by the Company s research and development department and was introduced in the second quarter of the fiscal year ended June 30, 1996. The Company has patents and certain licensed patent rights covering varying aspects of TRIAZ®. TRIAZ® products are manufactured to the Company s specifications on a purchase order basis by West Pharmaceutical Services Lakewood, Inc. (West Pharmaceutical Services) and in accordance with a supply agreement with Contract Pharmaceuticals.

OVIDE® Lotion, 0.5% is a topical pediculicide indicated for the treatment of pediculus humanus capitis, or head lice, and their ova and is available in 2-ounce bottles. Head lice products accounted for $170 million in sales in 1998 in the United States. Approximately 10 to 12 million Americans, mostly school-age children, are infested with head lice each year, and a growing body of evidence indicates significant levels of head lice that are resistant to currently available OTC treatments like NIX® and RID®. The Company believes OVIDE® is a prescription alternative to the OTC treatments, offering both an excellent kill rate and ovicial activity. In addition, in controlled clinical studies, OVIDE® demonstrated residual activity with 90.4% of patients still lice-free 7 days after treatment. Until OVIDE®, the only prescription pediculicide available was lindane. Because of CNS toxicity potential, the FDA required a labeling change recommending lindane s use only for patients who

have either failed to respond to adequate doses or are intolerant of other approved therapies. Used as directed, the Company believes OVIDE® provides safe and effective control of head lice and their ova. The Company introduced OVIDE® during the fourth quarter of fiscal 1999. OVIDE® is manufactured for the Company by West Pharmaceutical Services on a purchase order basis.

LIDEX® is a high-potency topical corticosteroid brand prescribed for the treatment of inflammatory and hyperproliferative skin diseases such as eczema, psoriasis, atopic dermatitis, poison ivy and other inflammatory skin conditions. Competing steroid brands in the high-potency category include Halog®, Elocon®, and Cyclocort®. LIDEX® was introduced more than 20 years ago and the Company believes it is among the most widely accepted topical steroid treatments available. Topical corticosteroid treatments had estimated market sales of $895 million in 2000. The active ingredient in LIDEX®, fluocinonide, works to alleviate inflammations of the skin by reducing swelling and pain, relieving itching and constricting blood vessels in the skin. The LIDEX® product line consists of various strengths and cosmetically elegant formulations, including gels, ointments, creams, solutions and emollient creams. The Company believes this broad product line allows dermatologists to prescribe the most appropriate product based on the severity and location of a patient s condition, as well as the thickness of a patient s skin. With the exception of the LIDEX®-E Cream, the various forms of LIDEX® are preservative-free, and the active ingredient is fully dissolved in the vehicle of the medication, resulting in better absorption of the medication into the skin. The Company believes LIDEX® is priced comparably to other branded corticosteroid products, but significantly higher than the average reported retail price of generic products containing fluocinonide. The Company acquired the rights to LIDEX® in the United States and Canada from Syntex (U.S.A.) Inc. and Syntex Pharmaceuticals International Limited, respectively, (Syntex) in the third quarter of the fiscal year ended June 30, 1997 (fiscal 1997). The Company has a manufacturing and supply agreement with Patheon, Inc. (Patheon) for the production of LIDEX® and also uses West Pharmaceutical Services to manufacture one LIDEX® product on a purchase order basis.

SYNALAR® is a mid- to low-potency topical corticosteroid brand prescribed for the treatment of less severe forms of inflammatory and hyperproliferative skin diseases such as eczema, psoriasis, poison ivy, atopic dermatitis and other inflammatory skin conditions. The active ingredient in SYNALAR®, fluocinolone acetonide, works to alleviate inflammations of the skin by reducing swelling and pain, relieving itching and constricting blood vessels in the skin. The SYNALAR® product line consists of various strengths and cosmetically elegant formulations, including ointments, creams, emollient creams and solutions. The Company believes this flexibility allows physicians to prescribe the most appropriate product based upon the severity and location of a patient s condition, as well as the thickness of a patient s skin. Competing steroid brands in the mid- and low-potency categories include Aristocort®, Cutivate® and Valisone®. SYNALAR® is priced comparably to other branded corticosteroid products but higher than the average reported price of generic products containing fluocinolone

acetonide. The Company acquired the rights to SYNALAR® in the United States and Canada from Syntex in the third quarter of fiscal 1997. The Company has a manufacturing and supply agreement with Patheon for the production of SYNALAR®.

TOPICORT® gels, creams, and ointments are Class II, high-potency corticosteroids indicated for topical use on corticosteroid-responsive inflammatory skin conditions, including psoriasis, contact dermatitis, seborrheic dermatitis, stasis dermatitis, rhus dermatitis, atopic dermatitis and more. TOPICORT® LP cream is a Class III corticosteroid. Class II, or high-potency steroids, offer effective treatment without the risks commonly associated with super-potent, Class I products. Unlike Class I steroids, TOPICORT® has no dosing restrictions and minimizes the hypothalamic-pituitary-adrenal (HPA) suppression commonly seen with Class I use. The Company believes TOPICORT® cream and gel have long been regarded as preferable to other available creams and gels because of their excellent cosmetic qualities. They do not contain propylene glycol (solvent), parabans (preservatives), or added fragrances that may cause irritation to patients with sensitive skin. Each of the TOPICORT® products is available in 15- and 60-gram tubes. Topical corticosteroid treatments had estimated market sales of $895 million in 2000. The Company licensed the rights to TOPICORT® in the United States from Aventis as successor-in-interest to HMR in November 1998. The Company has a manufacturing and supply agreement with Aventis for the production of TOPICORT®.

BUPHENYL® is an orphan drug that was approved by the FDA in 1986 as an adjunctive therapy for the treatment of hyperammonemia in patients with Urea Cycle Disorder. The product provides an alternative pathway to ureagenesis for waste nitrogen disposal and helps maintain nitrogen homeostasis. Urea cycle disorder is a rare genetic defect that effects the hepatic urea cycle, which is responsible for protein metabolism. Protein is normally broken down to nitrogen and excreted as urea. However, patients with deficiencies have either absent or significantly reduced synthesis of urea that prevents normal nitrogen homeostasis, causing ammonia and other nitrogenous compounds to accumulate in the blood. The Company acquired this product when it purchased Ucyclyd Pharma, Inc. (Ucyclyd), in April 1999. The Company has a supply agreement with Pharmaceutics International Inc. (PII) for the production of BUPHENYL®.

NON-PRESCRIPTION PRODUCT

The Company derived revenue from sales of an OTC product, ESOTERICA®, and from contract revenue in fiscal 2001. A description of the Company s non-prescription product follows.

ESOTERICA®, the leading fade cream line in the United States, is a line of topical creams used to treat minor skin discoloration conditions such as age spots, uneven skin tones, dark patches, blotches and freckles. ESOTERICA® is available in five formulations, consisting of four creams containing various concentrations of the active ingredient hydroquinone and a body lotion. The Company believes hydroquinone is the only agent proven to reduce hyperpigmentation and the only product legally sold in the United States for this purpose. Competing OTC products used to treat minor skin discolorations include Porcelana® and AMBI®, which are sold in a variety of creams, gels and lotions. The Company has a manufacturing agreement for the production of ESOTERICA® with Contract Pharmaceuticals.

PRODUCTS IN DEVELOPMENT

Medicis has developed and obtained rights to certain pharmaceutical agents in various stages of development. The Company has a variety of products under development, ranging from new products to existing product line extensions to reformulations of existing products. The Company s strategy involves the rapid evaluation and formulation of new therapeutics by obtaining preclinical safety and efficacy data, when possible, followed by rapid safety and efficacy testing in humans. While development periods vary, the Company generally selects products for internal development with the objective of proceeding from formulation to product launch within a two-year period. With the Company s increasing financial strength, Medicis has begun adding long-term projects to its development pipeline and may add longer-term projects with inherently greater risk in the future. The Company has in the past supplemented, and may in the future supplement, its research and development efforts by entering into research and development agreements with other pharmaceutical and biotechnology companies to defray certain costs and risks of product development.

The Company directs the efforts of contract laboratory research facilities to perform formulation and research work on active ingredients, as well as to conduct preclinical studies and clinical trials. All products and technologies under development require significant commitments of personnel and financial resources. Several products require extensive clinical evaluation and premarketing clearance by the United Stated Food and Drug Administration (FDA) and comparable agencies in other countries prior to commercial sale. Certain of the products and technologies under development have been licensed from third parties. The failure of the Company to meet its obligations under one or more of these agreements could result in the termination of the Company s rights under such agreements and other liabilities. In addition, the Company regularly reevaluates its product development efforts. On the basis of these reevaluations, the Company has in the past, and may in the future, abandon development efforts for particular products. There can be no assurance that any product or technology under development will result in the successful introduction of any new product.

The Company s research and development costs for Company-sponsored and unreimbursed co-sponsored pharmaceutical projects for fiscal 2001, 2000 and 1999 were $25,500,000, $4,903,000, and $3,396,000 respectively. Research and development costs for fiscal 2001 includes $17.0 million paid to Corixa Corporation (Corixa) for a development, commercialization and license agreement covering Corixa s novel psoriasis immunotherapeutic product and $788,000 of research and development expenses related to this agreement. Under the terms of the agreement, there are additional potential development milestone payments of $35 million and potential commercialization and cumulative net sales threshold milestone payments of $55 million.

In November 1998, the Company licensed the right to manufacture, market and sell the LOPROX®, TOPICORT® and A/T/S® products from Aventis as successor-in-interest to HMR. The licensing of these products also included several in-process research and development projects, including LOPROX® Gel, which was launched in fiscal 2000. Although the Company intends to continue such development projects, there can be no assurance that any technology previously under development by Aventis will result in the successful introduction of any additional new line extensions, or that the Company will continue the development of any such projects in the future.

MARKETING AND SALES

Medicis believes that its prescription pharmaceutical marketing and sales organization is one of the most productive in the dermatology sector. The Company s marketing efforts are focused on assessing and meeting the needs of dermatologists, podiatrists and other specialties that treat conditions of the skin. The Company s prescription sales team, consisting of 74 members at June 30, 2001, regularly calls on dermatologists, focusing on the approximately 3,200 dermatologists who are responsible for 80% of all prescriptions written by dermatologists in the United States. The sales team also calls on high-prescribing podiatrists. The Company believes it has created for its sales team an attractive incentive program based upon goals in market-share growth and market-share maintenance. The Company focuses on cultivating relationships of trust and confidence with the specialists themselves. In addition, the Company uses a variety of marketing techniques to promote its products including: sampling, journal advertising, promotional materials, specialty publications, rebate coupons, money-back or product

replacement guarantees, a leadership position in educational conferences and exposure of its products on the Internet.

The Company s OTC product is promoted to retailers and wholesalers by manufacturers representatives who also support a substantial number of products of other manufacturers. The Company also markets its OTC product through internally developed trade promotions, radio and print advertising, couponing and by increasing consumer awareness.

WAREHOUSING AND DISTRIBUTION

Medicis utilizes an independent national warehousing corporation to store and distribute its products from primarily two regional warehouses in Nevada and Georgia, as well as an additional warehouse in Maryland. Upon the receipt of a purchase order through electronic data input (EDI), phone, mail or facsimile, the order is processed into the Company s inventory systems. An inventory picking sheet is then automatically placed via EDI to the most efficient warehouse location for shipment, usually within 24 hours, to the customer placing the order. Upon shipment, the warehouse sends back to the Company via EDI the necessary information to automatically process the invoice in a timely manner.

CUSTOMERS

The Company s customers include the nation s leading wholesale pharmaceutical distributors, such as McKesson Corporation (McKesson), AmerisourceBergen Corporation (AmerisourceBergen), Cardinal Health, Inc. (Cardinal), Quality King Distributors (Quality King) and major drug chains. During fiscal 2001, Cardinal, McKesson and Quality King accounted for 22.2%, 18.0% and 10.3%, respectively, of the Company s net revenues. During fiscal 2000, Cardinal, McKesson, Quality King and AmerisourceBergen accounted for 21.0%, 18.1%, 11.3% and 10.2%, respectively of the Company s net revenues. During fiscal 1999, McKesson and Cardinal accounted for 18.0% and 14.1% respectively, of the Company s net revenues. The distribution network for pharmaceutical products has, in recent years, been subject to increasing consolidation. As a result, a few large wholesale distributors control a significant share of the market. In addition, the number of independent drug stores and small chains has decreased as retail consolidation has occurred. Further consolidation among, or any financial difficulties of, distributors or retailers could result in the combination or elimination of warehouses which may result in product returns to the Company, cause a reduction in the inventory levels of distributors and retailers, or otherwise result in reductions in purchases of the Company s products, any of which could have a material adverse impact on the Company s business, financial condition and results of operations.

MANUFACTURING

Medicis currently contracts for all of its manufacturing needs and is required by the FDA to contract only with manufacturers that comply with current Good Manufacturing Practices (cGMP) regulations and other applicable laws and regulations. The Company typically enters into short-term manufacturing contracts with third-party manufacturers.

Watson, as successor-in-interest to Schein, manufactures the Company s DYNACIN® product line in compliance with the Company s specifications and quality standards pursuant to a supply agreement. Under the agreement, Watson manufactures DYNACIN® for sale in the branded market exclusively for the Company, but may manufacture and sell minocycline for itself or others as a generic product. Watson currently manufactures minocycline for the generic market under its own label. The Company s supply agreement expires in December 2003, but is subject to automatic renewal for successive two-year periods if neither party gives timely notice of termination. It may also be terminated by either party without cause upon 12 months notice to the other party. Watson may also terminate the exclusivity portion of the agreement if its profit margin on sales of DYNACIN® products falls below a specified level. The agreement also provides that the Company will purchase all of its requirements for minocycline from Watson but may purchase some of its requirements from another manufacturer if Watson fails to meet certain cost standards or fails to provide the Company with all of its requirements for two of four consecutive quarters. In addition, the Company may use alternative sources if Watson terminates the Company s exclusive rights to purchase branded minocycline based upon the Company s failure to meet the specified profit

margins, as defined. Either party may terminate the agreement if one party cannot perform under the agreement for a period of three months or longer for certain reasons beyond its control. The Company believes that it has alternative sources of supply and that it would be able to use these alternative sources to preserve an adequate supply of DYNACIN®. However, the inability of any supplier to fulfill the Company s supply requirements for DYNACIN®, the Company s largest-selling product, in a timely fashion, would have a material adverse effect on the Company s business, financial condition and results of operations.

The Company s LUSTRA®, LUSTRA-AF®, ALUSTRA , PLEXION , PLEXION TS , TRIAZ® and ESOTERICA® products are manufactured by Contract Pharmaceuticals pursuant to manufacturing agreements which expire in July 2002, but are subject to renewal.

The Company s LOPROX® and TOPICORT® products are manufactured by Aventis in accordance with a supply agreement entered into by the Company in connection with the license of LOPROX® and TOPICORT®. The Aventis supply agreement expires in November 2001; however, the Company plans to extend the agreement through an automatic two-year extension.

The majority of the Company s LIDEX® and SYNALAR® products are manufactured primarily by Patheon in accordance with a manufacturing and supply agreement assumed by Medicis when it acquired the LIDEX® and SYNALAR® products. Under the terms of an agreement with the Company, F. Hoffman-La Roche, Ltd. supplies, at cost, active ingredients necessary for manufacturing the LIDEX® and SYNALAR® products. The Patheon manufacture and supply agreement expires in January 2002; however, the Company plans to extend this agreement through an automatic one year extension, which is available each year by contract unless either party gives timely notice of termination.

The Company s BUPHENYL® products are manufactured by PII pursuant to a supply agreement that expires in August 2004, but is subject to renewal.

CERTAIN LICENSE AND ROYALTY AGREEMENTS

Pursuant to license agreements with third parties, Medicis has acquired rights to manufacture, use or market certain of its existing products, as well as many of its proposed products and technologies. Such agreements typically contain provisions requiring the Company to use its best efforts or otherwise exercise diligence in pursuing market development for such products in order to maintain the rights granted under the agreements and may be canceled upon the Company s failure to perform its payment or other obligations. In addition, the Company has entered into agreements to license certain rights to manufacture, use and sell certain of its technologies outside the United States and Canada to various licensees.

In May 2001, the Company entered into an exclusive agreement with Abbott Laboratories (Abbott) for Medicis to promote OMNICEF® (cefdinir) capsules. Medicis will promote OMNICEF® in the U.S. market to dermatologists and podiatrists and will receive revenue from prescriptions generated in these categories.

In September 1999, the Company purchased VECTRIN®, a branded minocycline HCl product line, and ownership of its Abbreviated New Drug Application (ANDA) from Warner Chilcott, plc (Warner Chilcott). The Company is making royalty payments and may be obligated to make additional milestone payments conditioned upon the occurrence of certain events.

In November 1998, the Company entered into a license agreement with Aventis as successor-in-interest to HMR. The license is for a term of three years with an option to purchase the products at the end of the term. The products licensed are LOPROX®, TOPICORT® and A/T/S®.

TRADEMARKS

The Company believes that trademark protection is an important part of establishing product and brand recognition. The Company owns more than 100 registered trademarks and trademark applications and has acquired the rights to several trademarks by license. United States federal registrations for trademarks remain in force for 10

years and may be renewed every 10 years after issuance, provided the mark is still being used in commerce. There can be no assurance that any such trademark or service mark registrations will afford the Company adequate protection, or that the Company will have the financial resources to enforce its rights under any such trademark or service mark registrations. The inability of the Company to protect its trademarks or service marks from infringement could result in the impairment of any goodwill which may be developed in such trademarks or service marks. Moreover, the Company s inability to use one or more of its trademarks or service marks, because of successful third-party claims to such marks, could have a material adverse effect on the Company s business, financial condition and results of operations.

From time to time, the Company receives communications from parties who allege that their trademark or service mark interests may be damaged either by the Company s use of a particular trademark or service mark or its registration of such trademark or service mark, and, on occasion, the Company also sends such communications to third parties. In general, the Company seeks to resolve such conflicts before an actual opposition to registration or suit for infringement is filed. There can, however, be no assurance that such actions will not be filed or that, if filed, they will not have a material adverse effect upon the Company s business, financial condition or results of operations.

PATENTS AND PROPRIETARY RIGHTS

The Company is pursuing several United States patent applications. There can be no assurance that patents will be issued with respect to any of these applications. The Company has acquired rights under certain patents and patent applications from third-party licensors. The Company has obtained patents on some of its products directed to aspects of certain of its products, including a United States patent expiring in October 2015 covering various formulations of its TRIAZ® product line, and a United States patent expiring in August 2017 covering its LUSTRA®, LUSTRA-AF® and ALUSTRA products.

The Company believes that its success will depend in part on its ability to obtain and maintain patent protection for its own inventions, and to obtain and maintain adequate licenses for the use of patents licensed or sublicensed by third parties. There can be no assurance that any patent issued to, or licensed by, the Company will provide protection that has commercial significance. In this regard, the patent position of pharmaceutical compounds is particularly uncertain. There can be no assurance that challenges will not be instituted against the validity or enforceability of any patent owned by or licensed to the Company or, if instituted, that such challenges will not be successful. The cost of litigation to uphold the validity and prevent infringement of patents can be substantial and require a significant commitment of management s time. Furthermore, there can be no assurance that others will not independently develop similar technologies or duplicate the technology owned by or licensed to the Company or design around the patented aspects of such technology. The Company only conducts complete searches to determine whether its products infringe upon any existing patents as it deems appropriate. There can be no assurance that the products and technologies the Company currently markets, or may seek to market in the future, will not infringe patents or other rights owned by others. A claim or finding of infringement on one of the Company s products could have a material adverse effect on the Company s business, financial condition and results of operation.

The Company believes that the laws governing the obtaining and enforcing of foreign patents are different than those for obtaining domestic patents. Therefore, the Company recognizes that its patent position, if any, may be different in the United States than in Europe or elsewhere. In addition, the protection provided by foreign patents once they are obtained may be different than that provided by domestic patents.

The Company relies and expects to continue to rely upon unpatented proprietary know-how and continuing technological innovation in the development and manufacture of many of its principal products. The Company s policy is to require all its employees, consultants and advisors to enter into confidentiality agreements with the Company. There can be no assurance, however, that these agreements will provide meaningful protection for the Company s trade secrets or proprietary know-how in the event of any unauthorized use or disclosure of such information. In addition, there can be no assurance that others will not obtain access to or independently develop similar or equivalent trade secrets or know-how.

COMPETITION

The pharmaceutical industry is characterized by intense competition, rapid product development and technological change. Competition is intense among manufacturers of prescription pharmaceuticals, such as for the Company s Key Products for the treatment of dermatological conditions, as well as among manufacturers in the OTC market for brands which compete with ESOTERICA®. Many of the Company s competitors are large, well-established pharmaceutical, chemical, cosmetic or health care companies with considerably greater financial, marketing, sales and technical resources than those available to the Company. Additionally, many of the Company s present and potential competitors have research and development capabilities that may allow them to develop new or improved products that may compete with the Company s product lines. The Company s products could be rendered obsolete or made uneconomical by the development of new products to treat the conditions addressed by the Company s products, technological advances affecting the cost of production, or marketing or pricing actions by one or more of the Company s competitors. Each of the Company s products competes for a share of the existing market with numerous products that have become standard treatments recommended or prescribed by dermatologists.

DYNACIN® competes with Minocin®, a branded minocycline product marketed by American Home Products (AHP) and with numerous generic minocycline products marketed by Watson, Barr Laboratories, Inc., Ranbaxy Pharmaceuticals Inc. and ESI Lederle, Inc. Other oral antibiotics utilized for the treatment of acne include erythromycin, doxycycline and tetracycline marketed in branded and generic forms by a variety of companies. The Company believes that LOPROX® competes primarily with Spectazole®, marketed by Ortho Dermatological and Nizoral®, marketed by Janssen Pharmaceutica, Inc (Janssen). The Company believes that its LUSTRA® line primarily competes with Solaquin Forte® and Glyquin®, marketed by ICN Pharmaceuticals, Inc. (ICN Pharmaceuticals) and Melanex®, marketed by Neutrogena Dermatologics. The Company believes that while PLEXION competes in the same market as Metrocream®, Metrogel®, and Metrolotion®, all marketed by Galderma Laboratories, Inc. (Galderma), it does not directly compete against these products as it is the only prescription cleanser indicated for the treatment of acne rosacea. The Company believes that PLEXION TS , a topical suspension treatment for comedonal acne, is a gentle alternative to other topical retinoid acne therapies. The Company believes that TRIAZ® competes with Benzamycin®, marketed by Dermik Laboratories, Inc. (Dermik Labs); Cleocin-T®, marketed by Watson; and Benzac®, marketed by Galderma and with generic products such as the prescription product clindamycin, marketed by various manufacturers. The Company believes that OVIDE® primarily competes with the OTC products Nix®, marketed by Warner-Lambert Consumer Healthcare (Warner-Lambert) and Rid®, marketed by Pfizer, Inc. (Pfizer) and

with generic products such as the prescription product lindane, marketed by various manufacturers. LIDEX®, SYNALAR® and TOPICORT® compete with a number of corticosteroid brands in the super-, high-, mid-, and low-potency categories for the treatment of inflammatory and hyperproliferative skin conditions. Competing brands include Halog® and Ultravate®, marketed by Bristol-Myers Squibb Company (Bristol-Myers); Elocon® and Diprolene®, marketed by Schering-Plough Corporation (Schering-Plough); Cyclocort and Aristocort, marketed by Fujisawa Healthcare, Inc.; Temovate® and Cutivate®, marketed by GlaxoSmithKline plc (GlaxoSmithKline) and Psorcon®, marketed by Dermik Labs. ESOTERICA® primarily competes with Porcelana®, marketed by Schwarzkopf & Dep, Inc. and Ambi®, marketed by Kiwi Brands, a division of Sara Lee Brands Corporation.

Several of the Company s products, including DYNACIN®, LIDEX®, SYNALAR® and TOPICORT® compete with generic (non-branded) pharmaceuticals, which claim to offer equivalent therapeutic benefits at a lower cost. In some cases, insurers and other third-party payors seek to encourage the use of generic products making branded products less attractive, from a cost perspective, to buyers.

GOVERNMENT REGULATION

The manufacture and sale of cosmetics and drugs are subject to regulation principally by the FDA and state and local authorities in the United States, and by comparable agencies in certain foreign countries. The Federal Trade Commission (FTC) and state and local authorities regulate the advertising of OTC drugs and cosmetics. The Food and Drug Act and the regulations promulgated thereunder, and other federal and state statutes and regulations, govern, among other things, the testing, manufacture, safety, effectiveness, labeling, storage, record keeping, approval, advertising and promotion of the Company s products. In general, products falling within the FDA s definition of new drugs require premarketing clearance by the FDA. Products falling within the FDA s definition of cosmetics or of drugs that are not new drugs and that are generally recognized as safe and effective do not require premarketing clearance.

The steps required before a new drug may be marketed in the United States include (i) preclinical laboratory and animal testing, (ii) submission to the FDA of an Investigational New Drug (IND) application, which must become effective before clinical trials may commence, (iii) adequate and well-controlled clinical trials to establish the safety and efficacy of the drug, (iv) submission to the FDA of a New Drug Application (NDA) and (v) FDA approval of the NDA prior to any commercial sale or shipment of the drug. In addition to obtaining FDA approval for each product, each domestic drug-manufacturing establishment must be registered with, and approved by, the FDA. Drug product manufacturing establishments located in California also must be licensed by the State of California in compliance with separate regulatory requirements.

Preclinical testing is generally conducted in laboratory animals to evaluate the potential safety and the efficacy of a drug. The results of these studies are submitted to the FDA as a part of an IND application, which must be approved before clinical trials in humans can begin. Typically, clinical evaluation involves a time consuming and costly three-phase process. In Phase I, clinical trials are conducted with a small number of subjects to determine the early safety profile, the pattern of drug distribution and metabolism. In Phase II, clinical trials are conducted with groups of patients afflicted with a specific disease to determine preliminary efficacy, optimal dosages and expanded evidence of safety. In Phase III, large-scale, multi-center, comparative trials are conducted with patients afflicted with a target disease to provide sufficient data to demonstrate the efficacy and safety required by the FDA. The FDA closely monitors the progress of each of the three phases of clinical trials and may, at its discretion, re-evaluate, alter, suspend or terminate the testing based upon the data that have been accumulated to that point and its assessment of the risk/benefit ratio to the patient.

In general, FDA approval is required before a new drug product may be marketed in the United States. However, most OTC drugs are exempt from the FDA s premarketing approval requirements. In 1972, the FDA instituted the ongoing OTC Drug Review to evaluate the safety and effectiveness of OTC drug ingredients then in the market. Through this process, the FDA issues monographs that set forth the specific active ingredients, dosages, indications and labeling statements for OTC drug ingredients that the FDA will consider generally recognized as safe and effective and therefore not subject to premarket approval. OTC drug ingredients are classified by the FDA in one of three categories: Category I ingredients which are deemed safe and effective for OTC use : Category II ingredients which are deemed not generally recognized as safe and effective for OTC use; and Category III ingredients which are deemed possibly safe and effective with studies ongoing. Based upon the results of these ongoing studies, the FDA may reclassify all Category III ingredients as Category I or Category II ingredients. For certain categories of OTC drugs not yet subject to a final monograph, the FDA usually permits such drugs to continue to be marketed until a final monograph becomes effective, unless the drug will pose a potential health hazard to consumers. Drugs subject to final monographs, as well as drugs that are subject only to proposed monographs, are subject to various FDA regulations concerning, for example, cGMP, general and specific OTC labeling requirements and prohibitions against promotion for conditions other than those stated in the labeling. OTC drug manufacturing facilities are subject to FDA inspection, and failure to comply with applicable regulatory requirements may lead to administrative or judicially imposed penalties.

The active ingredient in DYNACIN®, minocycline; LOPROX®, ciclopirox; TOPICORT®, desoximetasone; OVIDE® lotion, malathion; BUPHENYL® powder and tablets, sodium phenylbutyrate; and LIDEX® and SYNALAR®, fluocinonide and fluocinolone acetonide,

respectively, have been approved by the FDA under an NDA. The active ingredient in the TRIAZ® products has been classified as a Category III ingredient under a tentative final FDA monograph for OTC use in treatment of labeled conditions. The FDA has requested, and a task force of the Non-Prescription Drug Manufacturers Association (NDMA), a trade association of OTC drug manufacturers, has undertaken further studies to confirm that benzoyl peroxide, an active ingredient in the TRIAZ® products, is not a tumor promoter when tested in conjunction with UV light exposure. The TRIAZ® products, which the Company sells on a prescription basis, have the same ingredients at the same dosage levels as the OTC products. When the FDA issues the final monograph, the Company may be required by the FDA to sell TRIAZ® as an OTC drug unless the Company files an NDA covering such product. There can be no assurance as to the results of these studies or any FDA action to reclassify benzoyl peroxide. In addition, there can be no assurance that adverse test results would not result in withdrawal of TRIAZ® from marketing. An adverse decision by the FDA with respect to the safety of benzoyl peroxide could result in the assertion of product liability claims against the Company and could have a material adverse effect on the Company s business, financial condition and results of operations.

Certain ESOTERICA® and LUSTRA® products contain the active ingredient hydroquinone at a 2% and 4% concentration, respectively. Independent expert dermatologists have formally expressed the view that hydroquinone is generally recognized as safe and effective for its intended use. Hydroquinone at a 2% concentration is currently a Category I ingredient under a tentative final monograph. In 1992, with the concurrence of the FDA, the industry initiated dermatological metabolism and toxicity studies to fully support hydroquinone s continued Category I status. Notwithstanding the pendency or results of these tests, the FDA may elect to classify hydroquinone as a Category III ingredient. The Company, in conjunction with the NDMA and other manufacturers, is responsible for 50% of the costs associated with these studies. An adverse decision by the FDA on the safety of hydroquinone could result in the assertion of product liability claims against the Company. Moreover, if hydroquinone is not maintained as a Category I or Category III ingredient, the Company would be required to cease marketing the ESOTERICA® and LUSTRA® products containing hydroquinone. An adverse decision by the FDA on the safety of hydroquinone could have a material adverse effect on the Company s business, financial condition and results of operations.

The ESOTERICA®, TRIAZ®, LUSTRA®, LUSTRA-AF® and ALUSTRA products must meet the composition and labeling requirements established by the FDA for products containing their respective basic ingredients. The Company believes that compliance with those established standards avoids the requirement for premarketing clearance of these products. There can be no assurance that the FDA will not take a contrary position. PLEXION and PLEXION TS , which contain the active ingredients sodium sulfacetamide and sulfur, are marketed under the FDA compliance policy entitled Marketed New Drugs without Approved NDAs or ANDAs.

The Company believes that certain of its products, as they are promoted and intended by the Company for use, are exempt from being considered new drugs based upon the introduction date of their active ingredients and therefore do not require premarketing clearance. There can be no assurance that the FDA will not take a contrary position. If the FDA were to do so, the Company may be required to seek FDA approval for such products, market such products as OTC products or withdraw such products from the market. The Company believes that such products are subject to regulations governing product safety, use of ingredients, labeling, promotion and manufacturing methods.

The Company also will be subject to foreign regulatory authorities governing clinical trials and pharmaceutical sales if it seeks to market its products outside the United States. Whether or not FDA approval has been obtained, approval of a product by the comparable regulatory authorities of foreign countries must be obtained prior to the commencement of marketing the product in those countries. The approval process varies from country to country and the time required may be longer or shorter than that required for FDA approval. There can be no assurance that any foreign regulatory agency will approve any product submitted for review by the Company.

EMPLOYEES

At June 30, 2001, the Company had 188 full-time employees. The Company believes its relationship with its employees is good. The Company intends to hire additional personnel as needed during the next 12 months and intends to expand the size of its sales force by 25%, or approximately 20 sales representatives, over the next 12 months.

FACTORS THAT MAY AFFECT FUTURE RESULTS

Our discussion and analysis in this report, in other reports that we file with the Securities and Exchange Commission, in our press releases and in public statements of our officers and corporate spokespersons contain forward-looking statements. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current events. They use words such as anticipate, estimate, expect, intend, plan, believe and other words of similar meaning in connectio discussion of future operating or financial performance. These include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, the outcome of contingencies such as legal proceedings and financial results.

Forward-looking statements may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many factors mentioned in this report for example, governmental regulation and competition in our industry will be important in determining future results. No forward-looking statement can be guaranteed, and actual results may vary materially from those anticipated in any forward-looking statement.

Medicis undertakes no obligation to update any forward-looking statement. We provide the following discussion of risks and uncertainties relevant to our business. These are factors that we think could cause our actual results to differ materially from expected and historical results. Medicis could also be adversely affected by other factors besides those listed here.

We Rely On Others To Manufacture Our Products

Currently, we contract out for all of our product manufacturing needs and do not manufacture any of our products. Typically, these manufacturing contracts are short-term. We are dependent upon renewing agreements with our existing manufacturers or finding replacement manufacturers to satisfy our requirements. As a result, we cannot be certain that manufacturing sources will continue to be available or that we can continue to out-source the manufacturing of our products on reasonable or acceptable terms.

The underlying cost to Medicis for manufacturing our products is established in our agreements with these outside manufacturers. Because of the short-term nature of these agreements, our expenses for manufacturing are not fixed and could change from contract to contract. If the cost of production increases, our gross margins could be negatively impacted.

In addition, we rely on outside manufacturers to provide us an adequate and reliable supply of our products on a timely basis. Any loss of a manufacturer or any difficulties which could arise in the manufacturing process could significantly affect our inventories and supply of products available for sale. In some cases, we do not have alternative sources of supply for our products. In the event our primary suppliers are unable to fulfill our requirements for any reason, it could have a negative effect on our sales margins and market share, as well as our overall business and financial results. If we are unable to supply sufficient amounts of our products on a timely basis, our market share could decrease and, correspondingly, our profitability could decrease.

We have entered into exclusive supply or manufacturing agreements for certain products, such as DYNACIN® and LIDEX®. Under these agreements, with certain exception, we must purchase most of our product supply from specific manufacturers. If any of these exclusive manufacturer or supplier relationships were terminated, we would be forced to find a replacement manufacturer or supplier. The FDA requires that all manufacturers used by pharmaceutical companies such as Medicis comply with the FDA s regulations, including those cGMP regulations applicable to manufacturing processes. The cGMP validation of a new facility and the approval of that manufacturer for a new drug product may take a year or more before manufacture can begin at the facility. Delays in obtaining FDA validation of a replacement manufacturing facility could cause an interruption in the supply of our products. Although we have business interruption insurance covering the loss of income for up to 12 months, which may mitigate the harm to Medicis from the interruption of the manufacturing of our largest selling products caused by certain events, the loss of a manufacturer could still have a negative effect on our sales, margins and market share, as well as our overall business and financial results.

Our Reliance On Third-Party Manufacturers And Suppliers Can Be Disruptive To Our Inventory Planning

We and the manufacturers of our products rely on suppliers of raw materials used in the production of our products. Some of these materials are available from only one source and others may become available from only one source. Any disruption in the supply of raw materials or an increase in the cost of raw materials to our manufacturers could have a significant effect on their ability to supply us with our products.

We try to maintain inventory levels that are no greater than necessary to meet our current projections. Any interruption in the supply of finished products could hinder our ability to timely distribute finished products. If we are unable to obtain adequate product supplies to satisfy our customers orders, we may lose those orders and our

customers may cancel other orders and stock and sell competing products. This in turn could cause a loss of our market share and negatively affect our revenues.

We cannot be certain that supply interruptions will not occur or that our inventory will always be adequate. Numerous factors could cause interruptions in the supply of our finished products including shortages in raw materials required by our manufacturers, changes in our sources for manufacturing, our failure to timely locate and obtain replacement manufacturers as needed and conditions effecting the cost and availability of raw materials.

The Growth Of Managed Care Organizations And Other Third-Party Reimbursement Policies May Have An Adverse Effect On Our Pricing Policies And Our Margins

Our operating results and business success depends in large part on the availability of adequate third-party payor reimbursement to patients for our prescription-brand products. These third-party payors include governmental entities (such as Medicaid), private health insurers and managed care organizations (MCOs). Over 70% of the U.S. population now participates in some version of managed care. Because of the size of the patient population covered by MCOs, marketing of prescription drugs to them and the pharmacy benefit managers (PBMs) that serve many of these organizations has become important to our business. MCOs and other third-party payors try to negotiate the pricing of medical services and products to control their costs. MCOs and PBMs typically develop formularies to reduce their cost for medications. Formularies can be based on the prices and therapeutic benefits of the available products. Due to their lower costs, generic products are often favored. The breadth of the products covered by formularies varies considerably from one MCO to another, and many formularies include alternative and competitive products for treatment of particular medical conditions. Exclusion of a product from a formulary can lead to its sharply reduced usage in the MCO patient population. Payment or reimbursement of only a portion of the cost of our prescription products could make our products less attractive, from a net-cost perspective, to patients, suppliers and prescribing physicians. We cannot be certain that the reimbursement policies of these entities will be adequate for our branded pharmaceutical products to compete on a price basis. If our products are not included within an adequate number of formularies or adequate reimbursement levels are not provided, or if those policies increasingly favor generic products, our market share and gross margins could be negatively affected, as could our overall business and financial condition.

Some of our products are not of a type generally eligible for reimbursement. It is possible that products manufactured by others could address the same effects as our products and be subject to reimbursement. If this were the case, some of our products may be unable to compete on a price basis.

Managed care initiatives to control costs have influenced primary-care physicians to refer fewer patients to dermatologists and other specialists. The result has been a declining market for dermatological products. Further reductions in these referrals could have a material adverse effect on the size of our potential market as well as our business, financial condition and results of operation.

Our Continued Growth Depends On Acquisitions

The Company s strategy for continued growth to a material extent involves the acquisition of new product lines or businesses. These acquisitions could be by acquiring other pharmaceutical companies, acquiring a portion of a company s assets or product lines, or obtaining licenses or other rights to manufacture and distribute products. Currently, we intend to focus our acquisition, licensing and development efforts on skin care products, which has been our historical focus, and possibly on other specialty pharmaceutical niches. We cannot be certain that we will be able to identify suitable acquisition candidates or products or if any will be available at all. In addition, even if suitable acquisitions are identified, we may not be able to secure terms which are beneficial. Other pharmaceutical companies with greater financial, marketing and sales resources than we have also tried to grow through these same acquisition and licensing strategies. Because of their greater resources, our competitors may be able to offer better terms for an acquisition than Medicis can offer, or they may be able to demonstrate a greater ability than Medicis to market licensed products.

Our Continued Growth Depends Upon Our Ability To Develop New Products

Medicis has internally developed potential pharmaceutical compounds and agents; we also have acquired the rights to certain potential compounds and agents in various stages of development. We currently have a variety of new products in various stages of research and development and are working on possible improvements, extensions and reformulations of some existing products. These research and development activities, as well as the clinical testing and regulatory approval process, which must be completed before commercial quantities of these developments can be sold, will require significant commitments of personnel and financial resources. Due to the limited financial resources available for research and development, there can be no assurance that we will be able to develop a product or technology in a timely matter, or at all. Delays in the research, development, testing or approval processes will cause a corresponding delay in revenue generation from those products. Regardless of whether they are ever released to the market, the expense of such processes will have already been incurred.

We reevaluate our research and development efforts regularly to assess whether our efforts to develop a particular product or technology are progressing at a rate that justifies our continued expenditures. On the basis of these reevaluations, we have abandoned in the past, and may

abandon in the future, our efforts on a particular product or technology. There can be no certainty that any product we are researching or developing will ever be successfully released to the market. If we fail to take a product or technology from the development stage to market on a timely basis, we may incur significant expenses without a near-term financial return.

We have in the past, and may in the future, supplement our internal research and development by entering into research and development agreements with other pharmaceutical companies. We may, upon entering into such agreements, be required to make significant up-front payments to fund the project. We cannot be sure, however, that we will be able to locate adequate research partners or that supplemental research will be available on terms acceptable to us in the future. If Medicis is unable to enter into additional research partnership arrangements, we may incur additional costs to continue research and development internally or abandon certain projects.

Our Business Strategy May Cause Fluctuating Operating Results

Our operating results and financial condition may fluctuate from quarter to quarter and year to year depending upon the relative timing of events or uncertainties which may arise. For example, the following events or occurrences could cause fluctuations in our financial performance from period to period:

changes in the levels we spend to develop, acquire or license new product lines;

changes in the amount we spend to promote our products;

delays between our expenditures to acquire new product lines or businesses and the generation of revenues from those acquired products or businesses;

changes in treatment practices of physicians that currently prescribe our products;

changes in reimbursement policies of health plans and other similar health insurers, including changes that affect newly developed or newly acquired products;

increases in the cost of raw materials used to manufacture our products;

development of new competitive products by others;

the mix of products that we sell during any time period; and

our responses to price competition.

Fluctuations In Demand For Our Products Create Inventory Maintenance Uncertainties

Medicis historically has experienced lower sales levels in the first quarter of our fiscal year (July 1 September 30). In addition, we typically experience greater revenues and, correspondingly, greater income during the last month of each fiscal quarter. We try to match our expenditures for inventory with these historical fluctuations in demand. However, if these demand patterns change or we experience even a small delay in delivery of inventory, revenue could be deferred or even lost if products are unavailable to meet peak demand. A deferral of revenue to a later period, or the loss of revenue completely, could cause significant period-to-period fluctuations in our operating

results, as a significant portion of our operating expenses are fixed in the short term. These fluctuations could result in our not meeting earnings expectations or result in operating losses for a particular period.

Medicis Is Subject To Extensive Governmental Regulation

Pharmaceutical companies are subject to heavy regulation by a number of national, state and local agencies. The FDA has jurisdiction over all of our business and administers requirements covering testing, manufacturing, safety, effectiveness, labeling, storage, record keeping, approval, advertising and promotion of our products. In addition, the FTC and state and local authorities regulate the advertising of OTC drugs and cosmetics. Failure to comply with applicable regulatory requirements could, among other things, result in fines; changes to advertising; suspensions of regulatory approvals of products; product recalls; delays in product distribution, marketing and sale; and civil or criminal sanctions.

Our prescription and OTC products receive FDA review regarding their safety and effectiveness. However, the FDA is permitted to revisit and change its prior determinations. We cannot be sure that the FDA will not change its position with regard to the safety or effectiveness of our products. If the FDA s position changes, we may be required to change our labeling or formulations, or cease to manufacture and market the challenged products. Even prior to any formal regulatory action, we could voluntarily decide to cease distribution and sale or recall any of our products if concerns about the safety or effectiveness develop.

Before marketing any drug that is considered a new drug by the FDA, the FDA must provide its premarketing approval of the product. All products which are considered cosmetics or drugs which are not new drugs and that generally are recognized by the FDA as safe and effective for use do not require the FDA s premarketing approval. We believe that some of our products, as they are promoted and intended for use, are exempt from treatment as new drugs and are not subject to premarketing approval by the FDA. The FDA, however, could take a contrary position and we could be required to seek FDA approval of those products and the marketing of those products. We could also be required to withdraw those products from the market.

In recent years, various legislative proposals have been offered in Congress and in some state legislatures that include major changes in the health care system. These proposals have included price or patient reimbursement constraints on medicines and restrictions on access to certain products. We cannot predict the outcome of such initiatives, and it is difficult to predict the future impact of the broad and expanding legislative and regulatory requirements affecting us.

We Face Significant Competition Within Our Industry

The pharmaceutical industry is highly competitive. Competition in our industry occurs on a variety of fronts, including developing and bringing new products to market before others, developing new technologies to improve existing products, developing new products to provide the same benefits as existing products at less cost and developing new products to provide benefits superior to those of existing products.

Many of our competitors are large, well-established companies in the fields of pharmaceuticals, chemicals, cosmetics and health care. Our competitors include AHP, Schering-Plough, Bristol-Myers, Elan Corporation, plc, Galderma, Dermik Labs, Ortho Pharmaceuticals, ICN Pharmaceuticals, Warner-Lambert, GlaxoSmithKline, Pharmacia & Upjohn, Pfizer and others. Many of these companies have greater resources than we do to devote to marketing, sales, research and development and acquisitions. As a result, they have a greater ability to undertake more extensive research and development, marketing and pricing policy programs. It is possible that our competitors may develop new or improved products to treat the same conditions as our products or make technological advances reducing their cost of production so that they may engage in price competition through aggressive pricing policies to secure a greater market share to our detriment. These competitors also may develop products which make our current or future products obsolete. Any of these events could have a significant negative impact on our business and financial results, including reductions in our market share and gross margins.

Medicis sells and distributes both prescription brands and an OTC product. Each of these products competes with products produced by others to treat the same conditions. Several of our prescription products,

including DYNACIN®, LIDEX®, SYNALAR® and TOPICORT®, compete with generic pharmaceuticals, which claim to offer equivalent benefit at a lower cost. In some cases, insurers and other health care payment organizations try to encourage the use of these less expensive generic brands through their prescription benefits coverages and reimbursement policies. These organizations may make the generic alternative more attractive to the patient by providing different amounts of reimbursement so that the net cost of the generic product to the patient is less than the net cost of our prescription brand product. Aggressive pricing policies by our generic product competitors and the prescription benefits policies of insurers could cause us to lose market share or force us to reduce our gross margins in response.

Our Success Depends On The Management Of Recent And Future Growth

Medicis recently experienced a period of rapid growth from both acquisitions and internal expansion of our operations. This growth has placed significant demands on our human and financial resources. We must continue to improve our operational, financial and management information controls and systems and effectively motivate, train and manage our employees to properly manage this growth. Even if these steps are taken, we cannot be sure that our recent acquisitions will be assimilated successfully into our business operations. If we do not manage this growth effectively, maintain the quality of our products despite the demands on our resources and retain key personnel, our business could be negatively impacted.

There Are High Costs Of Obtaining FDA And Other Regulatory Approvals

The process of obtaining FDA and other regulatory approvals is lengthy and expensive. Clinical trials are required and the marketing and manufacturing of pharmaceutical products are subject to rigorous testing procedures. We may not be able to obtain FDA approval to conduct clinical trials or to manufacture and market any of the products we develop, acquire or license. Moreover, the costs to obtain approvals could be considerable and the failure to obtain or delays in obtaining an approval could have a significant negative effect on our business performance and financial results. Even if premarketing approval from the FDA is received, the FDA is authorized to impose post-marketing requirements such as:

- testing and surveillance to monitor the product and its continued compliance with regulatory requirements;
- submitting products for inspection and, if any inspection reveals that the product is not in compliance, the prohibition of the sale of all products from the same lot;
- suspending manufacturing;
- recalling products; and
- withdrawing marketing clearance.

In its regulation of advertising, the FDA from time to time issues correspondence to pharmaceutical companies alleging that some advertising or promotional practices are false, misleading or deceptive. The FDA has the power to impose a wide array of sanctions on companies for such advertising practices, and the receipt of correspondence from the FDA alleging these practices could result in the following:

- incurring substantial expenses, including fines, penalties, legal fees and costs to comply with the FDA s requirements;
- changes in the methods of marketing and selling products;
- taking FDA-mandated corrective action, which may include placing advertisements or sending letters to physicians rescinding previous advertisements or promotion; and
- disruption in the distribution of products and loss of sales until compliance with the FDA s position is obtained.

Dependence Of Licenses From Others

We have acquired the right to manufacture, use or market certain products, including certain of our Key Products. We also expect to continue to obtain licenses for other products and technologies in the future. Our license

agreements generally require us to develop a market for the licensed products. If we do not exert enough efforts to develop these markets, the licensors may be entitled to terminate these license agreements.

We cannot be certain that we will fulfill all of our obligations under any particular license agreement for any variety of reasons, including insufficient resources to adequately develop and market a product, lack of market development despite our diligence and lack of product acceptance. Our failure to fulfill our obligations could result in the loss of our rights under a license agreement.

Our inability to continue the distribution of any particular licensed product could have a material negative effect on our business, market share and profitability. Also, certain products we license are used in connection with other products we own or license. A loss of a license in such circumstances could materially harm our ability to market and distribute these other products.

Our growth and acquisition strategy depends upon the successful integration of licensed products with our existing products. Therefore, any loss, limitation or flaw in a licensed product could impair our ability to market and sell our products, delay new product development and introduction, and/or adversely affect our reputation. These problems, individually or together, could have a material adverse effect on our business and results of operation.

We have granted licenses to certain products. We cannot be certain that a licensee will fulfill their obligations under such licenses. The non-performance of a licensee for our products could have a material adverse effect on our business and results of operations.

Adequacy Of Trademarks, Patents And Proprietary Rights

We believe that the protection of our trademarks and service marks is an important factor in product recognition, maintaining goodwill and in maintaining or increasing market share. If we do not adequately protect our rights in our various trademarks and service marks from infringement, any goodwill which has been developed in those marks could be lost or impaired. If the marks we use are found to infringe upon the trademark or service mark of another company, we could be forced to stop using those marks and, as a result, we could lose all the goodwill which has been developed in those marks and could be liable for damages caused by an infringement.

We are pursuing several U. S. patent applications, although we cannot be sure that any of these patents will ever be issued. We also have acquired rights under certain patents and patent applications in connection with our licenses to distribute products and by assignment of rights to patents and patent applications from certain of our consultants and officers. These patents and patent applications may be subject to claims of rights by third parties. If there are conflicting claims to the same patent or patent application, we may not prevail and, even if we do have some rights in a patent or application, those rights may not be sufficient for the marketing and distribution of products covered by the patent or application.

The patents and applications in which we have an interest may be challenged as to their validity or enforceability. Challenges may result in potentially significant harm to our business. The cost of responding to these challenges and the inherent costs to defend the validity of our patents, including the prosecution of infringements and the related litigation, could be substantial. Such litigation also could require a substantial commitment of management s time.

The ownership of a patent or an interest in a patent does not always provide significant protection. Others may independently develop similar technologies or design around the patented aspects of our technology. We only conduct patent searches to determine whether our products infringe upon any existing patents when we think such searches are appropriate. As a result, the products and technologies we currently market, and those we may market in the future, may infringe on patents and other rights owned by others. If we are unsuccessful in any challenge to the marketing and sale of our products or technologies, we may be required to license the disputed rights, if the holder of those rights is willing, or to cease marketing the challenged products, or to modify our products to avoid infringing upon those rights. A claim or finding of infringement regarding one of our products could have a material adverse effect on the Company s business, financial condition and results of operations. The costs of responding to infringement claims could be substantial and could require a substantial commitment of management s time.

We also rely upon unpatented proprietary know-how and continuing technological innovation in developing and manufacturing many of our principal products. Medicis requires all of its employees, consultants and advisors to enter into confidentiality agreements prohibiting them from taking our proprietary information and technology. Nevertheless, these agreements may not provide meaningful protection for our trade secrets and proprietary know-how if they are used or disclosed. Despite all of the precautions we may take, people who are not parties to confidentiality agreements may obtain access to our trade secrets or know-how. In addition, others may independently develop similar or equivalent trade secrets or know-how.

Product Liability

Medicis is exposed to risks of product liability claims from allegations that our products resulted in adverse effects to the patient or others. These risks exist even with respect to those products that are approved for commercial sale by the FDA and manufactured in facilities licensed and regulated by the FDA.

In addition to our desire to reduce the scope of our potential exposure to these types of claims, many of our customers require us to maintain product liability insurance as a condition of conducting business with us. We currently carry product liability insurance in the amount of $50.0 million per claim and $50.0 million in the aggregate on a claims-made basis. Nevertheless, this insurance may not be sufficient to cover all claims made against us. We also cannot be certain that our current coverage will continue to be available in the future on reasonable terms, if at all. If we are liable for any product liability claims in excess of our coverage or outside of our coverage, the cost and expense of such liability could severely damage our business, financial condition and profitability.

ITEM 2: PROPERTIES

Medicis presently occupies approximately 49,000 square feet of office space in Scottsdale, Arizona, at an average annual expense of $1,346,000, under a lease agreement that expires in February 2010. The lease contains certain rent escalation clauses and, upon expiration, can be renewed for two additional periods of five years each. Rent expense was approximately $1,430,000, $1,024,500, and $564,000 for fiscal 2001, 2000 and 1999, respectively.

Medicis Canada, Inc., a wholly owned subsidiary, presently leases approximately 7,500 square feet of office and warehouse space in St-Laurent, Quebec, Canada, under a lease agreement that expires in April 2002.

ITEM 3: LEGAL PROCEEDINGS

The Company and certain of its subsidiaries are parties to actions and proceedings incident to their businesses, including litigation regarding our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. The Company believes liability in the event of final adverse determinations in any of these matters is either covered by insurance and/or established reserves, or, should not, in the aggregate, have a material adverse effect on the business, financial position or results of operations of the Company. There can be no assurance, however, that an adverse determination on any action or proceeding will not have a material adverse effect on the business, financial condition and results of operations of the Company, or that the Company will be able to realize the full amount of any indemnification obligation that any person may have to the Company or that any such indemnification will adequately cover any liability.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the security holders of the Company during the fourth quarter of fiscal 2001.

PART II

ITEM 5: MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Dividend Policy

The Company has never declared a cash dividend. The Company intends to retain any earnings to fund future growth and the operation of its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future.

Price Range of Common Stock

Medicis Class A Common Stock trades on the New York Stock Exchange under the symbol MRX . The following table sets forth, for the fiscal periods indicated, the range of high and low sales prices for the Class A Common Stock of the Company on the New York Stock Exchange:

	HIGH	LOW
FISCAL YEAR ENDED JUNE 30, 2001		
First Quarter	$67.75	$50.13
Second Quarter	74.75	45.63
Third Quarter	62.75	31.00
Fourth Quarter	58.35	42.75
FISCAL YEAR ENDED JUNE 30, 2000		
First Quarter	$32.88	$20.25
Second Quarter	43.75	22.75
Third Quarter	51.94	35.25
Fourth Quarter		

64.75 34.25

On September 19, 2001, the last reported sale price on the New York Stock Exchange for Medicis Class A Common Stock was $43.64 per share. As of such date, there were approximately 241 holders of record of Class A Common Stock.

ITEM 6: SELECTED FINANCIAL DATA

The following selected financial data has been derived from the consolidated financial statements of Medicis Pharmaceutical Corporation for the fiscal years 2001, 2000, 1999, 1998 and 1997. Gross profit does not include amortization of the related intangibles.

	JUNE 30,				
	2001	**2000**	**1999**	**1998**	**1997**
	(in thousands, except per share data)				
Statements of Operations Data:					
Net revenues	$167,801	$139,099	$116,871	$77,571	$41,159
Gross profit	137,105	113,188	95,236	63,592	31,797
Operating expenses:					
Selling, general and administrative	59,507	45,404	38,219	27,424	16,484
Research and development expenses	25,516	4,903	3,396	2,885	1,450
Depreciation and amortization	8,261	7,375	5,810	2,903	999
In-process research and development		9,500	35,400		
Total operating expenses	93,284	57,682	56,925	68,612	18,933

Operating income (loss)	43,821	55,506	38,311	(5,020)	12,864
Other:					
Gain on sale of assets			17,650		
Net interest income	15,504	11,875	9,678	7,037	3,787
Income tax (expense) benefit	(18,905)	(24,387)	(24,202)	(14,424)	694
Net income (loss)	$40,420	$42,994	$41,437	$(12,407)	$17,345
Basic net income (loss) per common share	$1.34	$1.48	$1.46	$(0.51)	$0.88
Diluted net income (loss) per common share	$1.28	$1.41	$1.41	$(0.51)	$0.83

Number of shares used in computing basic net income (loss) per common share
30,134 29,029 28,414 24,102 19,788

Number of shares used in computing diluted net income (loss) per common share
31,694 30,499 29,462 24,102 20,891

	JUNE 30,				
	2001	2000	1999	1998	1997
			(in thousands)		
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$334,157	$285,737	$237,304	$237,921	$85,132
Working capital	358,468	312,302	278,612	262,956	94,803
Total assets	548,696	495,340	467,510	352,350	140,537

Long-term obligations
14,914 34,716 95 111
Stockholders equity
503,454 437,439 373,748 324,495 131,565

	JUNE 30,				
	2001	2000	1999	1998	1997
			(in thousands)		
Cash Flow Data:					
Net cash provided by operating activities	70,620	41,238	25,424	14,745	13,787

ITEM 7: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which describe the Company's objectives, intentions, goals, strategies, outlook or expectations. Forward-looking statements involve risks and uncertainties. The Company s actual results could differ materially from those anticipated in any forward-looking statements as a result of a variety of factors, including those discussed under the heading Factors that May Affect Future Results .

OVERVIEW

Medicis is a specialty pharmaceutical company and the leading independent pharmaceutical company in the United States focusing primarily on the treatment of dermatological conditions. Medicis offers prescription products and an over-the-counter (OTC) product, emphasizing the clinical effectiveness, quality, affordability and cosmetic elegance of its products. Medicis develops and markets leading products for major segments within dermatology, including acne, fungal infections, rosacea, hyperpigmentation, photoaging psoriasis, eczema, skin and skin-structure infections, seborrheic dermatitis, head lice and cosmesis (improvement in the texture and appearance of skin). Medicis has built its business by successfully executing a four-part growth strategy. The Company s growth strategy includes: (1) expanding sales of existing brands; (2) launching new products from research and development efforts; (3) acquiring complementary stragetic products, businesses and technologies; and (4) collaborating with other companies.

The Company s primary products include the prescription brands DYNACIN® (minocycline HCl), LOPROX® (ciclopirox), LUSTRA®, LUSTRA-AF , and ALUSTRA (hydroquinone), PLEXION and PLEXION TS (sodium sulfacetamide/sulfur), TRIAZ® (benzoyl peroxide), OVIDE® (malathion) and BUPHENYL® (sodium phenylbutyrate), a prescription product indicated in the treatment of Urea Cycle Disorder, and the over-the-counter brand ESOTERICA®.

Medicis derives a majority of its revenue from sales of its DYNACIN®, LOPROX®, LUSTRA®, LUSTRA-AF®, ALUSTRA , PLEXION , PLEXION TS , TRIAZ®, OVIDE® and BUPHENYL® products (the Key Products). The Company believes that sales of the Key Products will constitute the majority of net revenues for the foreseeable future. Accordingly, any factor adversely affecting the sale of the Key Products, individually or collectively, could have a material adverse effect on the Company s business, financial condition and results of operations. In December 2000, a generic version of the Company s DYNACIN® 75 mg. product was approved by the FDA. The Company cannot, at this time, validate its assumptions of the full impact of the approval of the competitive product on its business nor can it determine the potential impact of future approvals of generic 75 mg. products. Each of the Key Products could be rendered obsolete or uneconomical by regulatory or competitive changes. The sale of the Key Products could also be adversely affected by other factors, including manufacturing or supply interruptions; the development of new competitive pharmaceuticals to treat the conditions addressed by the Key Products; technological advances; factors affecting the cost of production; marketing or pricing actions by one or more of the Company s competitors; regulatory action by the FDA; changes in the prescribing practices of dermatologists; changes in the reimbursement policies of third-party payors; product liability claims; the outcome of disputes relating to trademarks, patents and other rights; or other factors.

The Company s results of operations may vary from period to period due to a variety of factors, including expenditures incurred to acquire, license and promote pharmaceuticals; expenditures and timing relating to the acquisition and integration of businesses; the introduction of new products by the Company or its competitors; cost increases from third-party manufacturers; manufacturing and supply interruptions; the availability and cost of raw materials; the mix of products sold by the Company; changes in marketing and sales expenditures; market acceptance of the Company s products; competitive pricing pressures; the outcome of disputes relating to trademarks, patents and other rights; general economic and industry conditions that affect customer demand; and the Company s level of research and development activities. As a result of customer buying patterns, a substantial portion of the Company s revenues has been in the last month of each quarter. The Company schedules its inventory purchases to meet anticipated customer demand. As a result, relatively small delays in the receipt of manufactured products by the Company could result in revenues being deferred or lost. The Company s operating expenses are based upon

anticipated sales levels, and a high percentage of the Company s operating expenses are relatively fixed in the short term. 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. There can be no assurance that the Company will maintain or increase revenues or profitability or avoid losses in any future period.

Medicis recognizes revenues from sales upon shipment to its customers. At the time of sale, the Company records reserves for possible returns based upon estimates using historical experience. Sales are reported net of actual and estimated product returns and net of pricing adjustments and/or discounts. The Company applies royalty obligations to the cost of sales in the period the corresponding sales are recognized.

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 up-front, non-refundable payments to third parties for research and development work which has been completed. Medicis, upon regulatory approval or commercialization of the product under development, may obtain the marketing rights. These up-front payments may be expensed at the time of payment depending on the nature of the payment made.

The Company plans to spend substantial amounts of capital to continue the acquisition of and the research and development of pharmaceutical products. Actual expenditures will depend upon the Company s financial condition, as well as the results of clinical testing, delays or changes in government-required testing and approval procedures, technological and competitive developments, and strategic marketing decisions. The Company may increase total expenditures for research and development and expects that research and development expenditures as a percentage of net revenues will fluctuate from period to period. The Company periodically makes up-front, non-refundable payments to third parties for research and development work which has been completed. If there is no recourse provision against the third party for their failure to perform future services to earn such amounts paid, these up-front payments are expensed at the time of payment. Payments made for product rights, whereby the product has received regulatory approval for sale, are capitalized and amortized over the expected revenue-producing periods. The Company can give no assurance that the research and development projects or payments will provide products or technologies that will be patentable, commercially feasible or acceptable to governmental agencies, including the FDA, whose approval and market authorization may be necessary.

The Company intends to seek additional licensing opportunities and acquisitions of products, companies or technologies to leverage its existing distribution channels and marketing infrastructure, to provide additional opportunities for growth, and to aggressively market new formulations of existing product lines. The Company can give no assurance that opportunities will be available on terms acceptable to the Company, if at all.

To enable Medicis to focus on its core marketing and sales activities, the Company selectively out-sources certain non-sales and non-marketing functions, such as laboratory research, manufacturing and warehousing. As the Company expands its activities in these areas, additional financial resources are expected to be utilized. The Company typically does not enter into long-term manufacturing contracts with third-party manufacturers. Whether or not such contracts exist, there can be no assurance that the Company will be able to obtain adequate supplies of such products in a timely fashion, on acceptable terms, or at all.

The success of the Company s growth efforts is subject to a number of risks and uncertainties, which include but are not limited to: dependence on sales of the Key Products; integration of new product or business acquisitions; possible delays or failure by Corixa or the Company to develop and/or commercialize any technology covered by the new collaborative agreement between the parties, possible risks related to adverse clinical results as products including any of such technology move into clinical trials, the impact of alternative technological advances and competition on the collaborative relationship between the parties, and inherent risks in early stage development of such technology; reliance upon third-party manufacturers to produce certain Key Products; the ability to effectively manage a changing business; uncertainties related to pharmaceutical pricing and reimbursement; and the uncertainty of competitive forces within the pharmaceutical industry that affects both the market for the Company s product, and the availability of product lines or businesses for acquisition that meet the Company s acquisition or licensing criteria. The future results of operations, both annually and from quarter to quarter, are subject to a variety of factors applicable to the Company and to the industries and markets in which it operates.

The Company s customers include the nation s leading wholesale pharmaceutical distributors, such as McKesson; AmerisourceBergen; Cardinal; Quality King and other major drug chains. During fiscal 2001, Cardinal, McKesson and Quality King accounted for 22.2%, 18.0% and 10.3%, respectively, of the Company s net revenues. During fiscal 2000, Cardinal, McKesson, Quality King and AmerisourceBergen accounted for 21.0%, 18.1%, 11.3% and 10.2%, respectively, of the Company s net revenues. During fiscal 1999, McKesson and Cardinal accounted for 18.0% and 14.1%, respectively, of the Company s net revenues. The loss of any of these customers accounts could have a material adverse effect

upon the Company s business, financial condition or results of operations.

RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements contained elsewhere herein. The following table sets forth certain data as a percentage of net revenues for the periods indicated.

Percentage of Net Revenues

	JUNE 30,		
	2001*	**2000**	**1999****
Net revenues	100.0%	100.0%	100.0%
Gross profit	81.7	81.4	81.5
Operating expenses	45.0	41.5	40.6
Operating income	36.7	39.9	40.9
Interest income, net	9.2	8.5	8.3
Income tax expense	(15.0)	(17.5)	(17.8)
Net income	30.9%	30.9%	31.4%

*Absent tax-effected research and development expense of $17.8 million related to collaboration with Corixa

**Absent tax-effected special charge for in-process research and development and tax-effected gain on divested products

The following table reflects certain selected unaudited quarterly operating results of the Company for each of the last eight quarters through the quarter ended June 30, 2001. The Company believes that all necessary adjustments have been included to fairly present the quarterly information. The operating results for any quarter are not necessarily indicative of the results for any future period. Gross profit does not include amortization of the related intangibles.

FISCAL 2001 AND FISCAL 2000 ANALYSIS
(in thousands, except per share data)

	Fiscal 2001				Fiscal 2000			
	Sept.*	Dec.	March	June	Sept.	Dec.	March	Ju
	(in thousands, except per share data)							
revenues	$40,254	$41,367	$42,346	$43,834	$31,644	$33,379	$35,049	$39,
s profit								
775	33,575	34,876	35,879	25,858	26,940	28,726	31,664	
rating expenses								
542	17,826	18,587	20,541	13,230	13,003	14,076	17,372	
rating income								
233	15,749	16,289	15,338	12,628	13,937	14,650	14,292	
ncome								
991	12,737	13,302	13,863	9,640	10,481	11,063	11,810	
ncome per common share:								
c								
0	$0.42	$0.44	$0.46	$0.34	$0.36	$0.38	$0.40	
ted								
8	$0.40	$0.42	$0.44	$0.33	$0.35	$0.36	$0.38	
es used in computing net income per common share:								
c								
645	30,274	30,414	30,209	28,750	28,834	29,164	29,375	
ted								
624	32,083	31,787	31,493	29,471	30,170	30,967	31,079	

*Absent tax-effected research and development expense of $17.8 million related to collaboration with Corixa

Quarterly results may vary from period to period due to a variety of factors, including: expenditures incurred to acquire, license and promote pharmaceutical products; expenditures and timing relating to the acquisition and integration of products or businesses; changes in the prescribing practices of physicians; the introduction of new products by the Company or its competitors; cost increases from third-party manufacturers; supply interruptions; the availability and cost of raw materials; the mix of products sold by the Company; changes in marketing and sales expenditures; market acceptance of the Company s products; competitive pricing pressures; the outcome of disputes relating to trademarks, patents and other rights; general economic and industry conditions that affect customer demand; and the Company s level of research and development activities. There can be no assurance that the Company will maintain or increase revenues or profitability or avoid losses in any future period.

Years ended June 30, 2001 and 2000

Net Revenues

Net revenues for fiscal 2001 increased 20.6%, or $28.7 million, to $167.8 million from $139.1 million for fiscal 2000. The Company s net revenues increased in fiscal 2001 primarily due to the addition of sales in the current fiscal year of its recently launched PLEXION and PLEXION TS product lines, increases in sales of the LUSTRA® products, as well as the addition of sales in the fourth quarter of its new ALUSTRA product and increases in sales of the Company s LOPROX® and TRIAZ® products.

Gross Profit

Gross profit during fiscal 2001 increased 21.1%, or $23.9 million, to $137.1 million from $113.2 million in fiscal 2000. As a percentage of net revenues, gross profit was 81.7% and 81.4% in fiscal 2001 and fiscal 2000, respectively. Gross profit increased primarily as a result of revenue associated with the LOPROX®, LUSTRA®,

PLEXION , PLEXION TS and BUPHENYL® products, which enjoy higher gross profit percentages than the Company s other products. Amortization of related intangible assets is not included in gross profit.

Selling, General and Administrative Expenses

Selling, general and administrative expenses in fiscal 2001 increased 31.1%, or $14.1 million, to $59.5 million from $45.4 million in fiscal 2000. As a percentage of net revenues, selling, general and administrative expenses increased 2.9 percentage points. This increase was primarily attributable to an increase in personnel costs. The increase in personnel costs was primarily due to an increase in the number of employees, to 188 in fiscal 2001 from 172 in fiscal 2000, and yearly salary escalations for existing employees. The increase was also due to variable costs commensurate with increased sales volumes.

Research and Development Expenses

Research and development expenses in fiscal 2001 increased $20.6 million, to $25.5 million from $4.9 million in fiscal 2000. This increase was primarily due to $17.0 million paid to Corixa for a development, commercialization and license agreement for a novel psoriasis immunotherapeutic product and $788,000 of research and development expenses related to this agreement. Absent these charges, research and development expenses in fiscal 2001 increased $2.8 million, or 57.6%, to $7.7 million from $4.9 million in fiscal 2000, primarily due to development efforts related to projects in the Company s pipeline and expenses associated with the clinical support of the Company s existing products.

Depreciation and Amortization Expenses

Depreciation and amortization expenses in fiscal 2001 increased 12.0%, or $0.9 million, to $8.3 million from $7.4 million in fiscal 2000. This increase was primarily attributable to the amortization of the intangible assets related to the minocycline ANDA that the Company acquired in September 1999.

Operating Income

Operating income for fiscal 2001 decreased $11.7 million, to $43.8 million from $55.5 million in fiscal 2000 primarily due to the research and development expense of $17.8 million related to the Corixa collaboration. Absent this charge, operating income increased $6.1 million, to $61.6 million from $55.5 million in fiscal 2000. This increase was primarily a result of higher sales volume offset by an increase in operating expenses.

Interest Income

Interest income in fiscal 2001 increased $2.7 million, to $16.8 million from $14.1 million in fiscal 2000, primarily due to higher average cash, cash equivalents and short-term investment balances during fiscal 2001. The Company s higher average cash, cash equivalents and short-term investment balances are primarily due to cash generated from operations, offset by the third payment of $22.0 million paid in November 2000 to Aventis, as successor-in-interest to HMR, relating to the license of the LOPROX®, TOPICORT® and A/T/S® products.

Interest Expense

Interest expense in fiscal 2001 decreased $1.0 million, to $1.2 million from $2.2 million in fiscal 2000. This decrease was primarily due to a decrease in the contract obligation recorded in connection with the license of the LOPROX®, TOPICORT® and A/T/S® products.

Income Tax Expense

Income tax expense during fiscal 2001 decreased $5.5 million, to $18.9 million from $24.4 million in fiscal 2000. The decrease in income tax expense was due to a decrease in pre-tax income. The decrease in pre-tax income was due to the research and development expense of $17.8 million related to the Corixa collaboration. The decrease in the effective tax rate in fiscal 2001, as compared to fiscal 2000, was primarily attributable to a change in

investment mix to non-taxable securities, contributions to charitable programs that receive favorable tax treatment and an increase in the Company s research and development credits.

Net Income

Net income during fiscal 2001 decreased approximately $2.6 million, to $40.4 million from $43.0 million in fiscal 2000. This decrease was primarily due to the tax-effected research and development expense of $11.5 million related to the Corixa collaboration. Absent this charge, net income increased 20.7%, or $8.9 million, to $51.9 million from $43.0 million in fiscal 2000. This increase was due primarily to an increase in sales volume and interest income, offset by an increase in strategic operating expenses.

Years ended June 30, 2000 and 1999

Net Revenues

Net revenues for fiscal 2000 increased 19.0%, or $22.2 million, to $139.1 million from $116.9 million for fiscal 1999. The Company s net revenues increased in fiscal 2000 primarily as a result of sales growth associated with the Company s DYNACIN®, LOPROX®, BUPHENYL® and TRIAZ® products. In fiscal 1999, the Company divested or licensed 16 non-strategic products to Bioglan Pharma plc (Bioglan). Net revenue associated with these products for fiscal 1999 was $19.3 million. Absent divested products, net revenues for fiscal 2000 increased 42.6%, or $41.6 million, to $139.1 from $97.5 million in fiscal 1999.

Gross Profit

Gross profit during fiscal 2000 increased 18.8%, or $18.0 million, to $113.2 million from $95.2 million in fiscal 1999. As a percentage of net revenues, gross profit was 81.4% and 81.5% in fiscal 2000 and fiscal 1999, respectively. Gross profit remained consistent primarily as a result of revenue associated with the LOPROX®, LUSTRA® and BUPHENYL® products, which enjoy higher gross profit percentages than the Company s other products, offset by an increase in revenues associated with the DYNACIN® products, which have lower gross profit percentages than the Company s other products. Amortization of related intangible assets is not included in gross profit.

Selling, General and Administrative Expenses

Selling, general and administrative expenses in fiscal 2000 increased 18.8%, or $7.2 million, to $45.4 million from $38.2 million in fiscal 1999. This increase was primarily attributable to an increase in personnel costs. The increase in personnel costs was primarily due to an increase in the number of employees, to 172 in fiscal 2000 from 144 in fiscal 1999, and yearly salary escalations for existing employees. The increase was also due to variable costs commensurate with increased sales volumes. Selling, general and administrative expenses as a percentage of net revenues in fiscal 2000 remained consistent from fiscal 1999.

Research and Development Expenses

Research and development expenses in fiscal 2000 increased 44.4%, or $1.5 million, to $4.9 million from $3.4 million in fiscal 1999. The increase was primarily due to the timing of various research and development projects and expenses associated with the clinical support of the Company s existing products.

Depreciation and Amortization Expenses

Depreciation and amortization expenses in fiscal 2000 increased 26.9%, or $1.6 million, to $7.4 million from $5.8 million in fiscal 1999. This increase was primarily attributable to a full year of amortization of the purchase price of the LOPROX®, TOPICORT® and A/T/S® products purchased by the Company in November 1998; the BUPHENYL® products purchased in April 1999; and the VECTRIN® products purchased in September 1999. The Company is amortizing the various purchase prices over a period of 15 to 25 years.

In-Process Research and Development

In fiscal 1999, the Company recorded a $9.5 million charge to operations as in-process research and development related to new indications and forms of certain products acquired, and had incurred additional charges for in-process research and development of $35.4 million in 1998. The acquired in-process research and development projects are in various stages of development, had not reached technological feasibility at the time of acquisition and had no known alternative uses.

The efforts required to develop the acquired in-process research and development into commercially viable products include completion of the development stages of the commercially viable products, clinical-trial testing, FDA approval and commercialization. Due to the nature of the

pharmaceutical development process, the Company anticipates incurring additional costs to develop these products. However, there is no certainty that any of these development efforts will result in commercially viable products.

A portion of the Company s in-process research and development projects acquired in 1998 related to OTC products. Such projects were discontinued during fiscal 1999 in conjunction with the Company s change in strategic focus to prescription products. Of the remaining acquired in-process research and development projects from 1998, the most significant project resulted in a new product introduction during late fiscal 1999, as that product was completed and commenced commercial sale. The Company continues its development efforts on the remaining projects that were acquired in both 1998 and 1999 in the in-process state. During fiscal 2000, the Company incurred development costs of approximately $500,000, and should all of the remaining projects continue to move toward commercialization, the Company estimates that future expenditures could approximate $4.0 million over the next few years.

Operating Income

Operating income for fiscal 2000 increased $17.2 million, to $55.5 million from $38.3 million in fiscal 1999. Absent special charges in fiscal 1999, operating income in fiscal 2000 increased 16.1%, or $7.7 million, to $55.5 million from $47.8 million in fiscal 1999. This increase was primarily a result of higher sales volume offset by an increase in cost of sales and operating expenses.

Interest Income

Interest income in fiscal 2000 increased $2.6 million, to $14.1 million from $11.5 million in fiscal 1999, primarily due to higher average cash, cash equivalents and short-term investment balances during fiscal 2000. The Company s higher average cash, cash equivalents and short-term investment balances are due to cash generated from operations and proceeds from the divestiture of non-strategic products in fiscal 1999, offset by a $22.0 million payment made in November 1999 to Aventis, as successor-in-interest to HMR, relating to the license of the LOPROX®, TOPICORT® and A/T/S® products, as well as payments made in association with the acquisitions of the company Ucyclyd, and the VECTRIN® products.

Interest Expense

Interest expense in fiscal 2000 increased $0.4 million, to $2.2 million from $1.8 million in fiscal 1999. This increase was primarily attributable to a full year of interest expense related to the contract obligation recorded in connection with the license of the LOPROX®, TOPICORT® and A/T/S® products.

Income Tax Expense

Income tax expense during fiscal 2000 increased $0.2 million, to $24.4 million from $24.2 million in fiscal 1999. The increase in income tax expense in fiscal 2000, as compared to fiscal 1999, was primarily due to an increase in pre-tax income in fiscal 2000. In fiscal 1999, pre-tax income included a gain of $17.7 million related to the sale of assets to Bioglan. Absent this gain on the divestiture of products, pre-tax income increased $19.4 million, to $67.4 million from $48.0 million in fiscal 1999. Income tax expense increased $7.2 million, to $24.4 million from

$17.1 million in fiscal 1999. The decrease in the effective tax rate in fiscal 2000, as compared to fiscal 1999, was primarily attributable to the implementation of tax-saving strategies and an increase in tax-exempt interest income.

Net Income

Net income during fiscal 2000 increased approximately $1.6 million, to $43.0 million from $41.4 million in fiscal 1999. Fiscal 1999 included special charges to operations for in-process research and development related to the license of LOPROX®, TOPICORT® and A/T/S®. Net income in fiscal 1999 also included $17.7 million related to a gain on the sale of assets to Bioglan. Absent tax-effected special charges and a tax-effected gain on divested products in fiscal 1999, net income increased approximately 17.3%, or $6.4 million, to $43.0 million from $36.6 million in fiscal 1999. This increase was due primarily to an increase in sales volume and interest income offset by an increase in depreciation and amortization and research and development expenses.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for fiscal 2001 increased $29.4 million, to $70.6 million from $41.2 million in fiscal 2000. The change is primarily due to an income tax receivable collected during fiscal 2001 and positive cash flow fluctuations in other balance sheet

accounts, offset by the research and development expense related to the Corixa collaboration, which reduced net income.

Net cash used in investing activities for fiscal 2001 increased $95.4 million, to $82.0 million from net cash provided by investing activities of $13.4 million in fiscal 2000. The change is primarily due to payments made for the license of product rights and the fluctuation in available-for-sale investments.

Net cash provided by financing activities increased $2.6 million, to $12.5 million from $9.9 million in fiscal 2000. The change is primarily attributable to proceeds received on the exercise of options under the Company s stock option plans, offset by the purchase of treasury stock.

The Company had cash, cash equivalents and short-term investments of $334.2 million and working capital of $358.5 million at June 30, 2001, as compared to $285.7 million and $312.3 million, respectively, at June 30, 2000.

OTHER MATTERS

On May 10, 2001, Abbott and Medicis entered into an exclusive agreement for Medicis to promote OMNICEF® (cefdinir) capsules. OMNICEF®, a cephalosporin antibiotic, is for the treatment of uncomplicated skin and skin structure infections. Medicis will promote OMNICEF® in the U.S. market to dermatologists and podiatrists and will receive revenue from prescriptions generated in these categories. Abbott will continue to promote OMNICEF® to primary care physicians and pediatricians. In the U.S., the market for treatment of bacterial skin and skin structure infections is estimated to be more than $1.5 billion.

On August 15, 2000, Medicis entered into a multi-year development, commercialization and license agreement covering Corixa s novel psoriasis immunotherapeutic product, PVAC . Under terms of the agreement, Medicis made a non-refundable payment to Corixa of $17.0 million at closing, with additional potential development milestone payments of $35 million, and potential commercialization and cumulative net sales threshold milestone payments of $55 million.

On September 21, 1999, the Company purchased VECTRIN®, a branded minocycline HCl product line, and ownership of its ANDA from Warner Chilcott. Under terms of the agreement, the Company paid Warner Chilcott $11.1 million cash at closing and paid an additional $2.0 million in contingent payments in April 2000. Additionally, the Company is making royalty payments and may be obligated to make additional milestone payments conditioned upon the occurrence of certain events.

On June 29, 1999, the Company sold the OTC products ZOSTRIX®, EXOREX and THERAPLEX® and the prescription product ZONALON® to Bioglan. Medicis received cash of $900,000 and issued a note receivable for $39.1 million, which was collected in July 1999. Under terms of the agreement, the Company paid IMX

Pharmaceuticals, Inc. $3.6 million subsequent to fiscal 1999 for the sale of its interest in the EXOREX joint venture.

On April 19, 1999, the Company acquired 100% of the common stock of Ucyclyd for net cash of approximately $14.3 million. Ucyclyd s primary product, the orphan drug BUPHENYL®, is indicated in the treatment of Urea Cycle Disorder. Under terms of the agreement, the Company paid $15.1 million at the close of the transaction, paid an additional $5.7 million in contingent payments in April 2000 and may be required to pay an additional $2.7 million upon regulatory approval of a product line extension.

On March 17, 1999, the Company sold nine non-strategic dermatological products to Bioglan for a net cash payment of $9.8 million. The products included in the sale were: A-FIL , AFIRM®, BENZASHAVE®, BETA-LIFTx®, METED®, PRAMEGEL®, PACKER S TAR SOAP®, THERAMYCIN Z® and TEXACORT®. Under a separate agreement, the Company licensed three additional products for a period of three years with a buyout option of $15.5 million at the end of the term. Under this agreement, Medicis receives quarterly license revenues. The products included in this license agreement are: OCCLUSAL-HP®, PENTRAX® and SALAC®.

In November 1998, the Company agreed to license, with an option to purchase, the LOPROX®, TOPICORT® and A/T/S® products from Aventis. The Company, using cash reserves, paid $22.0 million on the close of the transaction, made another payment of $22.0 million in November 1999 and another payment of $22.0 million in November 2000. The Company has the option to purchase the products for $16.5 million in November 2001. The purchase price is recorded at its discounted value as a short-term obligation. The discount is being recorded as interest expense over the related period. For accounting purposes, the Company has recorded the transaction as an acquisition. In conjunction with this acquisition, the Company recorded a charge to operations of $9.5 million, based upon an independent valuation, relating to acquired in-process research and development for projects that are in various stages of development, have not reached technological feasibility, and have no known alternative future uses.

Inflation did not have a significant impact upon the results of the Company during fiscal 2001, 2000 or 1999.

EFFECTS OF RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS No. 141), and No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives. The Company is currently reviewing the impact of SFAS No. 141 and SFAS No. 142. The Company is required to adopt SFAS No. 141 for business combinations commencing after July 1, 2001, and is required to adopt SFAS No. 142 on July 1, 2002. The Company is evaluating the provisions of SFAS No. 142 and the interpretations being developed to determine whether the Company will implement SFAS No. 142 as of July 1, 2001, which is permitted under the standard. The Company has not yet determined the potential impact of the standard and whether the Company will adopt the provision early.

MARKET RISK AND RISK MANAGEMENT POLICIES

The Company is exposed to market risk primarily from interest rates and, to a lesser extent, from changes in foreign currency exchange rates. The following describes the nature of the risks and demonstrates that, in general, such market risk is not material to the Company.

The Company is exposed to interest rate fluctuations on its short-term investments that are comprised of U.S. corporate securities and other debt securities, which it holds on an available-for-sale basis. A 100 basis-point change in the prime rate or other indicative base rates would not materially change the interest income that the Company expects to receive.

The Company has minimal operations outside of the United States and, therefore, has no significant risk to changes in foreign currencies. In addition, the Company has only one form of debt that is in the form of a discounted contract obligation, which, in effect, is a fixed-rate debt not subject to market rate fluctuations.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company s financial statements and schedule at June 30, 2001 and 2000 and for each of the three years in the period ending June 30, 2001 and the Independent Auditors Report thereon are contained on pages F-1 through F-20 and S-1 of this Form 10-K.

ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

ITEM 11: EXECUTIVE COMPENSATION

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for by each of Items 10, 11, 12 and 13 is incorporated by reference to the Company s definitive proxy statement for the 2001 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A.

PART IV

ITEM 14: EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Page

(a) Documents filed as a part of this Report

(1) Financial Statements:

Financial statement schedules not included in this Annual Report on Form 10-K have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(3) Exhibits filed as part of this Report:

Exhibit No.		Description
2.1	-	Agreement of Merger by and between Medicis Pharmaceutical Corporation, a Delaware corporation, Medicis Acquisition Corporation, a Delaware corporation, and GenDerm Corporation, a Delaware corporation, dated November 28, 1997 (13)
3.1	-	Certificate of Incorporation of the Company, as amended (6)
3.3 (a)	-	Amended and Restated By-Laws of the Company (15)
4.1	-	Rights Agreement, dated August 17, 1995, between the Company and American Stock Transfer & Trust Company, as Rights Agent (6)
4.1 (b)	-	Amendment No. 2 to Rights Agreement, dated March 17, 1997, between the Company and Norwest Bank Minnesota, N.A. (11)
4.3	-	Form of specimen certificate representing

Class A Common Stock (1)10.8 - Medicis Pharmaceutical Corporation 1995 Stock Option Plan (incorporated by reference to Exhibit C to the definitive Proxy Statement for the 1995 Annual Meeting of Shareholders previously filed with the SEC, File No. 0-18443)10.9 - Employment Agreement between the Company and Jonah Shacknai, dated July 24, 1996 (10)10.9 (a) - Amendment to Employment Agreement by and between the Company and Jonah Shacknai, dated April 1, 1999 (17)10.9 (b) - Amendment to Employment Agreement by and between the Company and Jonah Shacknai, dated February 21, 2001 (17)10.10 - Medicis Pharmaceutical Corporation 1988 Stock Option Plan, as amended (2)10.18 - Medicis Pharmaceutical Corporation 1990 Stock Option Plan, as amended (2)10.58 - Medicis

Pharmaceutical Corporation 1992 Stock Option Plan (4)10.59 - Supply Agreement, dated October 21, 1992, between Schein and the Company (3)10.70 - Amendment to Manufacturing and Supply Agreement, dated March 2, 1993, between Schein and the Company (5)10.72(a) - Credit and Security Agreement, dated August 3, 1995, between the Company and Norwest Business Credit, Inc. (7)10.72(b) - First Amendment to Credit and Security Agreement, dated May 29, 1996,

Exhibit No.	Description
between the Company and Norwest Bank Arizona, N.A. (10)10.72(c) - Second Amendment to Credit and Security Agreement, dated November 22, 1996, by and between the Company and Norwest Bank Arizona, N.A. as successor-in-interest to Norwest Business	

Credit, Inc.
(12)10.72(d) - Third Amendment to Credit and Security Agreement, dated November 22, 1998 by and between the Company and Norwest Bank Arizona, N.A., as successor-in-interest to Norwest Business Credit, Inc.
(14)10.72(e) Fourth amendment to Credit and Security Agreement, dated November 22, 2000 by and between the Company and Wells Fargo Bank Arizona, N.A., formerly known as Norwest Bank Arizona, N.A., as successor-in-interest to Norwest Business Credit, Inc.
(18)10.73(a) - Patent Collateral Assignment and Security Agreement, dated August 3, 1995 by the Company to Norwest Business Credit, Inc.
(8)10.73(b) - First Amendment to Patent Collateral Assignment and Security Agreement, dated May 29, 1996, by the Company to Norwest Bank Arizona, N.A.
(10)10.73(c) - Amended and Restated Patent Collateral Assignment and Security Agreement, dated November 22, 1998, by the Company to Norwest Bank Arizona, N.A.
(14)10.74(a) - Trademark Collateral Assignment and Security Agreement, dated August 3, 1995, by the

Company to Norwest Business Credit, Inc. (9)10.74(b) - First Amendment to Trademark Collateral Assignment and Security Agreement, dated May 29, 1996, by the Company to Norwest Bank Arizona, N.A. (10)10.74(c) - Amended and Restated Trademark, Tradename, and Service Mark Collateral Assignment and Security Agreement, dated November 22, 1998, by the Company to Norwest Bank Arizona, N.A. (14)10.75 - Assignment and Assumption of Loan Documents, dated May 29, 1996, from Norwest Business Credit, Inc., to and by Norwest Bank Arizona, N.A. (10)10.76 - Multiple Advance Note, dated May 29, 1996, from the Company to Norwest Bank Arizona, N.A. (10)10.77 - Securities Account Pledge and Security Agreement, dated November 22, 1996, by and between the Company and Norwest Bank Arizona, N.A. (12)10.77(a) - First Amendment to Securities Account Pledge and Security Agreement dated November 22, 1998, by and between the Company and Norwest Bank Arizona, N.A. (14)10.78 - Acknowledgment of Control of Pledged Securities Account, dated

November 22, 1996, by and among Norwest Bank Arizona, N.A. and the Company and Norwest Bank Minnesota, N.A. (12)10.78(a) - First Amendment to Acknowledgement of Control of Pledged Securities Account dated November 22, 1998, by and between the Company and Norwest Bank Arizona, N.A. (14)10.89 - Asset Purchase Agreement dated November 15, 1998, by and among the Company and Hoechst Marion Roussel, Inc., Hoechst Marion Roussel Deutschland GMHB and Hoechst Marion Roussel, S.A. (14)10.90 - License and Option Agreement dated November 15, 1998, by and among the Company and Hoechst Marion Roussel, Inc., Hoechst Marion Roussel Deutschland GMBH and Hoechst Marion Roussel, S.A. (14)10.91 - Loprox Lotion Supply Agreement dated November 15, 1998, by and between the Company and Hoechst Marion Roussel, Inc. (14)10.92 - Supply Agreement dated November 15, 1998, by and between the Company and Hoechst Marion Roussel Deutschland GMBH (14)10.93 - Asset Purchase Agreement effective January 31, 1999, between the

Company and Bioglan Pharma Plc (16)10.94 - Stock Purchase Agreement by and among the Company, Ucyclyd Pharma, Inc. and Syed E. Abidi, William Brusilow, Susan E. Brusilow and Norbert L. Wiech, dated April 19, 1999 (16)10.95 - Asset Purchase Agreement by and between the Company and Bioglan Pharma Plc dated June 29, 1999 (16)

Exhibit No.	Description
10.96 - Asset Purchase Agreement by and among The Exorex Company, LLC, Bioglan Pharma Plc, the Company and IMX Pharmaceuticals, Inc. dated June 29, 1999 (16)10.97 - Medicis Pharmaceutical Corporation Executive Retention Plan (16)10.98 Asset Purchase Agreement between Warner Chilcott, plc and the Company, dated September 14, 1999(16)21.1 - Subsidiaries (16)23.1 - Consent of Ernst & Young LLP, Independent Auditors (18)24. 1 - Power of Attorney(18) See	

signature page(s)

(1) Incorporated by reference to the exhibit with the same number in the Registration Statement on Form S-1 of the Registrant, File No. 33-32918, filed with the SEC on January 16, 1990

(2) Incorporated by reference to the exhibit with the same number in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 1992, as amended, File No. 0-18443, previously filed with the SEC

(3) Incorporated by reference to the exhibit with the same number in Registration Statement on Form S-1 of the Company, File No. 33-54276, filed with the SEC on June 11, 1993

(4) Incorporated by reference to Exhibit B to the Company s definitive Proxy Statement for its 1992 Annual Meeting of Shareholders, File No. 0-18443, previously filed with the SEC

(5) Incorporated by reference to the exhibit with the same number in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 1993, File No. 0-18443, filed with the SEC on October 13, 1993

(6) Incorporated by reference to the exhibit with the same number in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 1995, File No. 0-18443, previously filed with the SEC (the 1994 Form 10-K)

(7) Incorporated by reference to exhibit number 4.2 in the 1995 Form 10-K

(8) Incorporated by reference to exhibit number 4.4 in the 1995 Form 10-K

(9) Incorporated by reference to exhibit number 4.5 in the 1995 Form 10-K

(10) Incorporated by reference to the exhibit with the same number in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 1996, File No. 0-18443, previously filed with the SEC

(11) Incorporated by reference to the exhibit with the same number in the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 1997, File No. 0-18443, previously filed with the SEC

(12) Incorporated by reference to the exhibit with the same number in the Company s Quarterly Report on Form 10-Q for the quarter ended December 31, 1996, File No. 0-18443, previously filed with the SEC

(13) Incorporated by reference to the exhibit with the same number in the Company s Current Report on Form 8-K filed with the SEC on December 15, 1997

(14) Incorporated by reference to the exhibit with the same number in the Company s Quarterly Report on Form 10-Q for the quarter ended December 31, 1998, File No. 0-18443, previously filed with the SEC

(15) Incorporated by reference to the exhibit with the same number in the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 1999, File No. 0-18443, previously filed with the SEC

(16) Incorporated by reference to the exhibit with the same number in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 1999, File No. 0-18443, previously filed with the SEC

(17) Incorporated by reference to the exhibit with the same number in the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, File No. 0-18443, previously filed with the SEC

(18) Filed herewith

(b) No reports on Form 8-K were filed with the SEC for the quarter ended June 30, 2001.

(c) The exhibits to this Form 10-K follow the Company s Financial Statement Schedule included in this Form 10-K.

(d) The Financial Statement Schedule to this Form 10-K appears on page S-1 of this Form 10-K.

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Jonah Shacknai and Mark A. Prygocki, Sr., or either of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and a all capacities, to sign any and all amendments to this Annual Report on Form 10-K and any documents related to this report and filed pursuant to the Securities and Exchange Act of 1934, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or their substitute or substitutes may lawfully do or cause to be done by virtue hereof.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: September 28, 2001

MEDICIS PHARMACEUTICAL CORPORATION

By: /s/ JONAH SHACKNAI
Jonah Shacknai
Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ JONAH SHACKNAI Jonah Shacknai	Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	September 28, 2001
/s/ MARK A. PRYGOCKI, SR. Mark A. Prygocki, Sr.	Executive Vice President, Chief Financial Officer, Corporate Secretary and Treasurer (Principal Financial and Accounting Officer)	September 28, 2001
/s/ ARTHUR G. ALTSCHUL, JR. Arthur G. Altschul, Jr.	Director	September 28, 2001
/s/ SPENCER DAVIDSON Spencer Davidson	Director	September 28, 2001
/s/ PETER S. KNIGHT, ESQ. Peter S. Knight, Esq	Director	September 28, 2001
/s/ MICHAEL A. PIETRANGELO Michael A. Pietrangelo	Director	September 28, 2001
/s/ PHILIP S. SCHEIN, M.D. Philip S. Schein, M.D.	Director	September 28, 2001
/s/ LOTTIE SHACKELFORD	Director	September 28, 2001

Lottie Shackelford

MEDICIS PHARMACEUTICAL CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Ernst & Young LLP, Independent Auditors

The Board of Directors and Stockholders of Medicis Pharmaceutical Corporation

We have audited the accompanying consolidated balance sheets of Medicis Pharmaceutical Corporation and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended June 30, 2001. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based upon our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial condition of Medicis Pharmaceutical Corporation and subsidiaries at June 30, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Phoenix, Arizona
August 8, 2001

MEDICIS PHARMACEUTICAL CORPORATION

CONSOLIDATED BALANCE SHEETS

JUNE 30,

	2001	2000
Assets		
Current assets:		
Cash and cash equivalents	$153,257,738	$152,270,780
Short-term investments	180,899,419	133,466,609
Accounts receivable, less allowances:		
2001: $5,050,000; 2000: $4,190,000	36,525,525	33,164,092
Inventories	8,750,474	10,001,731
Deferred tax assets	4,805,270	3,366,268
Other current assets	14,640,434	19,018,672
Total current assets	398,878,860	351,288,152
Property and equipment, net	1,964,396	1,758,946
Intangible assets:		
Intangible assets related to product line and business acquisitions	160,274,323	156,569,425
Other intangible assets	10,875,675	899,414
	171,149,998	157,468,839
Less: accumulated amortization	23,873,544	16,286,738
Net intangible assets	147,276,454	141,182,101
Other non-current assets	576,408	1,110,356

$548,696,118	$495,339,555

See accompanying notes.

MEDICIS PHARMACEUTICAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	JUNE 30,	
	2001	**2000**
Liabilities		
Current liabilities:		
Accounts payable	$12,531,256	$10,554,984
Short-term contract obligation	16,160,010	22,000,000
Income taxes payable	262,620	
Other current liabilities	11,456,686	6,431,617
Total current liabilities	40,410,572	38,986,601
Long-term liabilities:		
Long-term contract obligation		14,913,603
Deferred tax liability	4,831,924	4,000,102
Commitments and Contingencies		
Stockholders Equity		
Preferred Stock, $0.01 par value; shares authorized: 5,000,000; no shares issued		
Class A Common Stock, $0.014 par value; shares authorized: 50,000,000;		

issued and outstanding: 30,120,095 and 29,069,085 at June 30, 2001 and 2000, respectively	421,681 406,967
Class B Common Stock, $0.014 par value; shares authorized: 1,000,000; issued and outstanding: 422,962 at June 30, 2001 and 2000	5,921 5,921
Additional paid-in capital	407,442,306 372,067,685
Accumulated other comprehensive income	611,218 479,410
Accumulated earnings	104,898,951 64,479,266
Treasury stock, 299,600 shares at cost	(9,926,455)
Total stockholders equity	503,453,622 437,439,249
	$548,696,118 $495,339,555

See accompanying notes.

MEDICIS PHARMACEUTICAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	YEAR ENDED JUNE 30,		
	2001	**2000**	**1999**
Net revenues	$167,801,480	$139,099,152	$116,870,540
Operating costs and expenses:			

Cost of sales	30,696,614	25,911,579	21,633,902
Selling, general and administrative	59,507,765	45,403,841	38,219,119
Research and development	25,515,552	4,902,715	3,396,393
Depreciation and amortization	8,260,938	7,374,534	5,810,288
In-process research and development			9,500,000
Operating costs and expenses	123,980,869	83,592,669	78,559,702
Operating income	43,820,611	55,506,483	38,310,838
Interest income	16,766,962	14,120,839	11,503,256
Interest expense	(1,262,653)	(2,245,578)	(1,825,200)
Gain on sale of assets			17,650,903
Income before taxes	59,324,920	67,381,744	65,639,797
Income tax expense	(18,905,235)	(24,387,562)	(24,202,571)
Net income	$40,419,685	$42,994,182	$41,437,226

Basic net income per common share	$1.34	$1.48	$1.46
Diluted net income per common share	$1.28	$1.41	$1.41
Shares used in computing basic net income per common share	30,133,514	29,028,896	28,413,608
Shares used in computing diluted net income per common share	31,693,702	30,498,776	29,462,311

See accompanying notes.

MEDICIS PHARMACEUTICAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Class A Common Stock		Class B Common Stock	
	Shares	Amount	Shares	Amount
Balance at June 30, 1998	27,712,837	$387,980	422,962	$5,921
Comprehensive income:				
Net income				
Net unrealized losses on available-for-sale securities				
Net unrealized gains on foreign currency translation				
Comprehensive income				
Exercise of stock options	526,432	7,370		
Tax effect of stock options exercised				
Options issued in lieu of payment for services rendered				
Balance at June 30, 1999	28,239,269	395,350	422,962	5,921
Comprehensive income:				
Net income				
Net unrealized gains on available-for-sale securities				
Net unrealized losses on foreign currency translation				
Comprehensive income				
Exercise of stock options	829,816	11,617		
Tax effect of stock options exercised				
Options issued in lieu of payment for services rendered				
Balance at June 30, 2000				

Comprehensive income:

29,069,085 406,967 422,962 5,921

Net income

Net unrealized gains on available-for-sale securities

Net unrealized losses on foreign currency translation

Comprehensive income

Exercise of stock options

1,051,010 14,714

Tax effect of stock options exercised

Options issued in lieu of payment for services rendered

Purchase of treasury stock

Balance at June 30, 2001

30,120,095 $421,681 422,962 $5,921

[Additional columns below]

[Continued from above table, first column(s) repeated]

	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated (Deficit) Earnings
Balance at June 30, 1998	$343,976,037	$77,689	$(19,952,142)
Comprehensive income:			
Net income			41,437,226
Net unrealized losses on available-for-sale securities		(371,619)	
Net unrealized gains on foreign currency translation		146	
Comprehensive income			
Exercise of stock options	3,834,839		
Tax effect of stock options exercised	4,329,969		
Options issued in lieu of payment for services rendered	15,000		
Balance at June 30, 1999	352,155,845	(293,784)	21,485,084
Comprehensive income:			
Net income			42,994,182
Net unrealized gains on available-for-sale securities		790,228	
Net unrealized losses on foreign currency translation		(17,034)	
Comprehensive income			
Exercise of stock options	10,162,400		
Tax effect of stock options exercised	9,728,440		
Options issued in lieu of payment for services rendered	21,000		

Balance at June 30, 2000	372,067,685	479,410	64,479,266
Comprehensive income:			
Net income		40,419,685	
Net unrealized gains on available-for-sale securities		261,331	
Net unrealized losses on foreign currency translation		(129,523)	
Comprehensive income			
Exercise of stock options	22,459,947		
Tax effect of stock options exercised	12,886,174		
Options issued in lieu of payment for services rendered	28,500		
Purchase of treasury stock			
Balance at June 30, 2001	$407,442,306	$611,218	$104,898,951

[Additional columns below]

[Continued from above table, first column(s) repeated]

Treasury Stock

	Shares	Amount	Total
Balance at June 30, 1998		$	$ 324,495,485
Comprehensive income:			
Net income			41,437,226
Net unrealized losses on available-for-sale securities			(371,619)
Net unrealized gains on foreign currency translation			146
Comprehensive income			41,065,753
Exercise of stock options			3,842,209
Tax effect of stock options exercised			4,329,969
Options issued in lieu of payment for services rendered			15,000
Balance at June 30, 1999			373,748,416
Comprehensive income:			
Net income			42,994,182
Net unrealized gains on available-for-sale securities			790,228
Net unrealized losses on foreign currency translation			(17,034)
Comprehensive income			43,767,376
Exercise of stock options			10,174,017
Tax effect of stock options exercised			9,728,440
Options issued in lieu of payment for services rendered			21,000
Balance at June 30, 2000			

	437,439,249		
Comprehensive income:			
Net income	40,419,685		
Net unrealized gains on available-for-sale securities	261,331		
Net unrealized losses on foreign currency translation	(129,523)		
Comprehensive income	40,551,493		
Exercise of stock options	22,474,661		
Tax effect of stock options exercised	12,886,174		
Options issued in lieu of payment for services rendered	28,500		
Purchase of treasury stock	(299,600)	(9,926,455)	(9,926,455)
Balance at June 30, 2001	(299,600)	$(9,926,455)	$503,453,622

See accompanying notes.

MEDICIS PHARMACEUTICAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEAR ENDED JUNE 30,		
	2001	**2000**	**1999**
Operating Activities:			

Net income	$40,419,685	$42,994,182	$41,437,226
Adjustments to reconcile net income to net cash provided by operating activities:			
In-process research and development		9,500,000	
Gain on sale of assets		(17,650,903)	
Depreciation and amortization	8,260,938	7,374,534	5,810,288
(Gain) loss on sale of available-for-sale investments	(1,324,558)	(483,038)	14,658
Other non-cash expenses	28,500	21,000	15,000
Deferred income tax (benefit) expense	(607,180)	2,947,647	(9,792,229)
Provision for doubtful accounts and returns	860,000	375,000	989,000
Accretion of premium on investments	178,486	508,323	179,649
Accretion of discount on contract obligation	1,246,407	2,197,147	1,801,885
Changes in operating assets and liabilities (net of acquired amounts):			
Accounts receivable	(4,221,433)	(1,956,157)	(13,285,268)
Inventories	1,251,257	(1,338,576)	2,298,397
Other current assets	4,378,238	(2,502,530)	(4,134,323)
Accounts payable	1,976,272	1,208,740	2,975,103
Income taxes payable	262,620	(10,659,944)	5,732,786
Tax benefit of option exercises	12,886,174	9,728,440	4,329,969
Other current liabilities	5,025,069	(9,176,278)	(4,796,891)
Net cash provided by operating activities	70,620,475	41,238,490	25,424,347
Investing Activities:			
Purchase of property and equipment	(849,686)	(628,941)	(725,165)
Proceeds from sale of product rights		39,100,000	10,712,402
Acquisition of businesses, net of cash acquired		(5,974,973)	(14,278,840)
Payments for purchase of product rights	(35,711,055)	(36,723,130)	(25,110,371)
Purchase of available-for-sale investments			

(200,515,584) (159,776,955) (202,169,056)
Sale of available-for-sale investments
50,807,177 29,937,533 52,644,964
Maturity of available-for-sale investments
104,183,000 147,170,951 89,711,000
Change in other assets
33,948 282,382 355,712

Net cash (used in) provided by investing activities
(82,052,200) 13,386,867 (88,859,354)
Financing Activities:

Payment of notes payable
(100,000) (105,920)
Change in other non-current liabilities
(130,278) 6,163
Purchase of treasury stock
(9,926,455)
Proceeds from the exercise of options
22,474,661 10,174,017 3,842,209

Net cash provided by financing activities
12,548,206 9,943,739 3,742,452
Effect of foreign currency exchange rate on cash and cash equivalents
(129,523) (17,034) 146

Net increase (decrease) in cash and cash equivalents
986,958 64,552,062 (59,692,409)
Cash and cash equivalents at beginning of year
152,270,780 87,718,718 147,411,127

Cash and cash equivalents at end of year	$153,257,738	$152,270,780	$87,718,718

See accompanying notes.

MEDICIS PHARMACEUTICAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001

NOTE 1. FORMATION AND DEVELOPMENT OF THE COMPANY

Medicis Pharmaceutical Corporation and its wholly owned subsidiaries (Medicis or the Company) is a specialty pharmaceutical company and the leading independent pharmaceutical company in the United States focusing primarily on the treatment of dermatological conditions. Medicis offers prescription products and an over-the-counter (OTC) product, emphasizing the clinical effectiveness, quality, affordability and cosmetic elegance of its products. Medicis develops and markets leading products for major segments within dermatology, including acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, eczema, skin and skin-structure infections, seborrheic dermatitis, head lice and cosmesis (improvement in the texture and appearance of skin). Medicis has built its business by successfully executing a four-part growth strategy. The Company s growth strategy includes: (1) expanding sales of existing brands; (2) launching new products from research and development efforts; (3) acquiring complementary strategic products, technologies, and businesses; and (4) collaborating with other companies.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Medicis and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation.

Cash and Cash Equivalents

At June 30, 2001, cash and cash equivalents included highly liquid investments invested in money market accounts consisting of government securities and high-grade commercial paper. These investments are stated at cost, which approximates fair value. The Company considers all highly liquid investments purchased with a remaining maturity of three months or less to be cash equivalents.

Investments

The Company accounts for investments under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities . The Company s debt securities are classified as available-for-sale. Available-for-sale securities are carried at fair value with the unrealized gains and losses reported in stockholders equity. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and interest and dividends on securities are included in interest income. The cost of securities sold is based upon the specific identification method.

Inventories

The Company 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 at the manufacturers facilities, and are valued at the lower of cost or market using the first-in, first-out method.

Inventories are as follows:

	June 30,	
	2001	2000
Raw materials	$3,066,582	$2,700,695
Finished goods	5,683,892	7,301,036
Total inventories	$8,750,474	$10,001,731

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful lives of property and equipment (three to five years). Leasehold improvements are amortized over the shorter of their estimated useful lives or the remaining lease term. Property and equipment consist of the following:

	June 30,	
	2001	2000
Furniture, fixtures and equipment	$2,896,202	$2,225,969
Leasehold improvements	502,611	480,970
	3,398,813	2,706,939
Less: accumulated depreciation	(1,434,417)	(947,993)

$1,964,396	$1,758,946

Intangible Assets

Intangible assets resulting from acquisitions of products and businesses principally consist of the excess of the fair value attributed to the related developed products and are being amortized on a straight-line basis over a 10- to 25-year period. The Company assesses the recoverability of intangible assets resulting from these acquisitions based upon expected future undiscounted cash flows on a product-line basis along with other relevant information.

Other Current Liabilities

Other current liabilities are as follows:

	June 30,	
	2001	**2000**
Accrued incentives	$4,132,927	$3,066,000
Other accrued expenses	7,323,759	3,365,617
	$11,456,686	$6,431,617

Revenue Recognition

The Company recognizes revenue pursuant to Staff Accounting Bulletin No. 101 Revenue Recognition in Financial Statements (SAB 101). Accordingly, revenue is recognized when all four of the following criteria are met: (i) persuasive evidence that arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is both fixed and determinable and; (iv) collectibility is reasonably probable.

Revenue from product sales is recognized upon shipment, net of discounts, rebates and estimated allowances for chargebacks and returns. The Company principally authorizes returns for damaged products and

exchanges for expired products in accordance with its Return Goods Policy and Procedures, and establishes reserves for such amounts at the time of sale. The Company has not experienced significant returns of damaged or expired products.

Advertising

The Company expenses advertising as incurred. Advertising expenses for the fiscal years ended June 30, 2001 (fiscal 2001), June 30, 2000 (fiscal 2000) and June 30, 1999 (fiscal 1999) were approximately $15,016,000, $11,521,000 and $11,922,000, respectively.

Stock-Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock option grants to employees in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and, accordingly, recognizes no compensation expense for employee stock option grants. All stock-based awards to non-employees are accounted for at their fair value in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) and Emerging Issues Task Force (EITF) Issue No. 96-18, Accounting for Equity Instruments that are Issued to Other than Employees.

Shipping Costs

Substantially all costs of shipping products to customers are included in selling, general and administrative expense.

Research and Development Costs

All research and development costs, including payments related to products under development and research consulting agreements, are expensed as incurred. The Company records expenses for up-front, non-refundable research and development payments in the period they are paid, given that there is no recourse provision against the collaboration partner for failing to continue to move the product toward commercialization. The timing of these payments will vary depending upon collaboration opportunities available to Medicis. Due to the uncertainty of when these opportunities may be available, Medicis cannot determine in which quarter these future payments may be made.

Income Taxes

Income taxes have been provided using the liability method in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes.

Earnings Per Share

Basic and diluted earnings per common share are calculated in accordance with the requirements of Statement of Financial Accounting Standards No. 128, Earnings Per Share (SFAS No. 128).

Statements of Cash Flows

Non-cash investing and financing activities were as follows:

	JUNE 30,		
	2001	2000	1999
Note receivable from the sale of assets	$	$	$ 39,100,000

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates based upon future events, which could include, among other risks, changes in the regulations governing the manner in which the Company sells its products, changes in the health care environment and the reliance on contract manufacturing services.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities reported in the consolidated balance sheets approximates fair value because of the immediate or short-term maturity of these financial instruments.

Segment Information

The Company adopted Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS No.131). SFAS No. 131 established standards for reporting information regarding operating segments in annual financial statements and requires selected information to be presented in interim financial reports issued to shareholders. SFAS No. 131 also established standards for related disclosures about products and services, geographic areas and major customers (see Note 12). The adoption of SFAS No. 131 did not affect the Company s consolidated financial position, results of operations or financial statement disclosures as the Company operates only one business segment.

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, (SFAS No. 133), Accounting for Derivative Instruments and Hedging Activities. This statement provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. In July 1999, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 137, which deferred the effective date of SFAS No. 133 for one year. In June 2000, the FASB issued Statement of Financial Accounting Standards No. 138, (SFAS No. 138), Accounting for Certain Derivative Instruments and Certain Hedging Activities an amendment to FASB Statement No. 133. This statement amended certain provisions of SFAS No. 133. The Company adopted SFAS No. 133 in the first quarter of fiscal 2001 with no effect to the Company s financial position or results of operations.

In December 1999, the Securities and Exchange Commission (SEC) issued SAB 101. SAB 101 provides guidance related to revenue recognition based upon interpretations and practices followed by the SEC. For the Company, SAB 101 was effective the quarter ended June 30, 2001. The adoption of SAB 101 did not have an impact on the financial position or results of operations of the Company.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS No. 141), and No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives. The Company is currently reviewing the impact of SFAS No. 141 and SFAS No. 142. The Company is required to adopt SFAS No. 141 for business combinations commencing after July 1, 2001, and is required to adopt SFAS No. 142 on July 1, 2002. The Company is evaluating the provisions of SFAS No. 142 and the interpretations being developed to determine whether the Company will implement SFAS No. 142 as of July 1, 2001, which is permitted under the standard. The Company has not yet determined the potential impact of the standard and whether the Company will adopt the provision early.

NOTE 3. STRATEGIC COLLABORATIONS

On May 10, 2001, Abbott Laboratories, Inc. (Abbott) and Medicis entered into an exclusive agreement for Medicis to promote OMNICEF® (cefdinir) capsules. OMNICEF®, a cephalosporin antibiotic, is for the treatment of uncomplicated skin and skin structure infections. Medicis will promote OMNICEF® in the U.S. market to dermatologists and podiatrists and will receive revenue from prescriptions generated in these categories. Abbott will continue to promote OMNICEF® to primary care physicians and pediatricians.

On August 15, 2000, Medicis entered into a multi-year development, commercialization and license agreement covering Corixa Corporation s (Corixa) novel psoriasis immunotherapeutic product, PVAC . Under terms of the agreement, Medicis made a non-refundable payment to Corixa of $17.0 million at closing, with additional potential development milestone payments of $35 million, and potential commercialization and cumulative net sales threshold milestone payments of $55 million. Additionally, upon regulatory approval and commercial sale of the product, Medicis will purchase inventory from Corixa and pay royalties on net sales of the product. Medicis also recorded $788,000 in research and development expenses related to this development, commercialization and license agreement. Medicis will continue to seek opportunities such as the Corixa collaboration to enhance its research and development pipeline. The Company records expenses for up-front, non-refundable research and development payments in the period they are paid, given that there is no recourse provision against the collaboration partner for failing to continue to move the product toward commercialization. The timing of these payments will vary depending upon collaboration opportunities available to Medicis. Due to the uncertainty of when these opportunities may be available, Medicis cannot determine in which quarter these future payments may be made.

NOTE 4. PRODUCT LINE AND BUSINESS ACQUISITIONS AND DIVESTITURES

On September 21, 1999, the Company purchased VECTRIN®, a branded minocycline HCl product line, and ownership of its Abbreviated New Drug Application (ANDA) from Warner Chilcott, plc (Warner Chilcott). Under terms of the agreement, the Company paid Warner Chilcott $11.1 million cash at closing and paid an additional $2.0 million in contingent payments in April 2000. Additionally, the Company is making royalty payments and may be obligated to make additional milestone payments conditioned upon the occurrence of certain events.

On June 29, 1999, the Company sold the OTC products ZOSTRIX®, EXOREX and THERAPLEX® and the prescription product ZONALON® to Bioglan Pharma, plc (Bioglan). Bioglan paid cash of $900,000 and issued a note receivable for $39.1 million, which was collected in July 1999. Under terms of the agreement, the Company purchased IMX Pharmaceutical, Inc. s 49.0% interest in the EXOREX joint venture for $3.6 million. On June 25, 1998, the Company paid $4.0 million for its 51.0% interest in the EXOREX joint venture.

On April 19, 1999, the Company acquired 100% of the common stock of Ucyclyd Pharma, Inc. (Ucyclyd), a privately held pharmaceutical company based in Baltimore, Maryland, for net cash of approximately $14.3 million. Ucyclyd s primary product, the orphan drug BUPHENYL®, is indicated in the treatment of Urea Cycle Disorder. Under terms of the agreement, the Company paid $15.1 million at the close of the transaction, paid an additional $5.7 million in contingent payments in April 2000, and may be required to pay an additional $2.7 million upon regulatory approval of a product line extension. The business acquired was not significant under Securities and Exchange Commission rules.

On March 17, 1999, the Company sold nine dermatological products to Bioglan for a net cash payment of $9.8 million. The products included in the transaction were: A-FIL , AFIRM®, BENZASHAVE®, BETA-LIFTx®, METED®, PRAMEGEL®, PACKER S TAR SOAP®, THERAMYCIN Z® and TEXACORT®. Under a separate agreement, the Company licensed three additional products to Bioglan for a period of three years with a buyout option of $15.5 million at the end of the term. Under this agreement, the Company receives quarterly license revenues. The products included in this license agreement were: OCCLUSAL-HP®, PENTRAX® and SALAC®.

On November 29, 1998, the Company agreed to license, with an option to purchase, the LOPROX®, TOPICORT® and A/T/S® products from Aventis Pharma (Aventis) as successor-in-interest to Hoechst Marion Roussel (HMR). The Company, using cash reserves, paid $22.0 million at the close of the transaction, made one

payment of $22.0 million in November 1999 and another payment of $22.0 million in November 2000. The Company has the option to purchase the products for $16.5 million in November 2001. The purchase price is recorded at its discounted value as a short-term obligation and the discount is being recorded as interest expense over the related period. For accounting purposes, the Company recorded the transaction as an acquisition. In conjunction with this acquisition, the Company recorded a charge to operations of $9.5 million, based upon an independent valuation, relating to acquired in-process research and development for projects that are in various stages of development, have not reached technological feasibility, and have no known alternative future uses.

The efforts required to develop the acquired in-process research and development into commercially viable products include completion of the development stages of the commercially viable products, clinical-trial testing, FDA approval and commercialization. Due to the nature of the pharmaceutical development process, the Company anticipates incurring additional costs to develop these products. However, there is no certainty that any of these development efforts will result in commercially viable products. During fiscal 2001, the Company incurred development costs of approximately $1.6 million related to the acquired in-process research and development, and should all of the remaining projects continue to move toward commercialization, the Company estimates that future expenditures could approximate $7.0 million over the next few years.

NOTE 5. SHORT-TERM INVESTMENTS

The Company s short-term investments are intended 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.

The following is a summary of available-for-sale securities:

	June 30, 2001			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Fair Value
U.S. corporate securities	$22,579,882	$160,837	$1,150	$22,739,569
Other debt securities 157,206,517 970,415 17,082 158,159,850				
Total securities $179,786,399 $1,131,252 $18,232 $180,899,419				

	June 30, 2000			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Fair Value
U.S. corporate securities	$32,807,598	$962,892	$157,011	$33,613,479
Other debt securities 99,886,342 45,621 78,833 99,853,130				

Total securities
$132,693,940 $1,008,513 $235,844 $133,466,609

During the years ended June 30, 2001 and 2000, the gross realized gains on sales of available-for-sale securities totaled $1,455,758 and $587,011, respectively, and the gross realized losses totaled $131,200 and $103,973, respectively. The net adjustment to unrealized gains during fiscal 2001 and fiscal 2000 on available-for-sale securities included in stockholders equity totaled $261,331 and $790,228, respectively. The amortized cost and estimated fair value of the available-for-sale securities at June 30, 2001, by maturity, are shown below. 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.

	JUNE 30, 2001	
	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	$134,109,532	$134,844,158
Due after one year through two years	44,100,722	44,470,139
Due after two years	1,576,145	1,585,122
	$179,786,399	$180,899,419

NOTE 6. DEBT

The Company has a revolving line of credit facility of up to $25.0 million from Wells Fargo Bank, N.A., formally known as Norwest Bank Arizona, N.A. The facility may be drawn upon by the Company, at its discretion, and is collateralized by principal assets of the Company. The outstanding balance of the credit facility bears interest at a floating rate of 150 basis points in excess of the 30-day London Interbank Offered Rate and expires in November 2002. The agreement requires the Company to comply with certain covenants, including covenants relating to the Company s financial condition and results of operation. The Company has not drawn on this credit facility.

NOTE 7. COMMITMENTS AND CONTINGENCIES

Occupancy Arrangements

The Company presently occupies approximately 49,000 square feet of office space, at an average annual expense of $1,346,000, under a lease agreement that expires in February 2010. The lease contains certain rent escalation clauses and, upon expiration, can be renewed for two additional periods of five years each. Rent expense was approximately $1,430,000, $1,024,500 and $564,000 in fiscal 2001, 2000 and 1999, respectively. The Company relocated to its present office space in Scottsdale, Arizona, in February 2000. At June 30, 2001, approximate future lease payments under the operating lease are as follows:

Year Ending June 30,	
2002	$1,253,700
2003	1,285,100
2004	1,328,900
2005	1,362,400
2006	1,409,200
Thereafter	5,049,600
	$11,688,900

Medicis Canada, Inc., a wholly owned subsidiary, presently leases approximately 7,500 square feet of office and warehouse space in St-Laurent, Quebec, Canada, under a lease agreement that expires in April 2002.

Research and Development and Consulting Contracts

The Company has, in the past, and may, in the future, enter into agreements with various research organizations and individuals under which the Company acquires certain patent and marketing rights for therapeutics developed under such agreements in exchange for providing funding for collaborative research. It is also anticipated that, before any commercial marketing can be commenced, the Company will be required to secure certain regulatory approvals on the technological processes involved.

The Company has various consulting agreements with certain scientists in exchange for the assignment of certain rights and consulting services. In addition, the Company has granted options to purchase shares of Class A Common Stock that are included in the stock option plan described in Note 10. These options vest annually over the

commitment periods. At June 30, 2001, the Company had approximately $867,300 of commitments (solely attributable to the Chairman of the Central Research Committee of the Company) payable over the remaining five years under an agreement that is cancelable by either party under certain conditions.

Licensing, Marketing and Manufacturing Agreements

The Company has entered into licensing and marketing agreements under which it has obtained rights to market certain existing and future pharmaceutical products. Generally, the terms of such agreements vary, but range from 10 to 20 years from the date of the first sale of the related product or until the expiration of the patent applicable to the product. The agreements provide for varying royalties with certain stated minimum annual amounts, which vary by agreement from $35,000 to $50,000. Total minimum royalties required to be paid on products currently being sold are approximately $85,000 per year.

The Company purchases its inventory from third party manufacturers, many of whom are the sole source of products for the Company. The failure of such manufacturers to provide an uninterrupted supply of products could adversely impact the Company s ability to sell such products.

Other

The Company and certain of its subsidiaries are parties to other actions and proceedings incident to their business. Liability in the event of final adverse determinations in any of these matters is either covered by insurance and/or established reserves, or, in the current opinion of management, after consultation with counsel, should not, in the aggregate, have a material adverse effect on the consolidated financial condition or results of operations of the Company.

NOTE 8. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets and liabilities are as follows:

	JUNE 30,			
	2001		2000	
	Current	Long-term	Current	Long-term
Deferred tax assets (liabilities):				
Net operating loss carry forwards	$	$95,000	$	$256,000
Reserves and liabilities	5,161,000		3,642,000	
Unrealized losses on securities		(356,000)		(276,000)
	4,805,000	95,000	3,366,000	256,000
Excess of net book value over tax basis of intangible assets		(4,927,000)		(4,256,000)

Deferred tax assets (liabilities)			
$4,805,000	$(4,832,000)	$3,366,000	$(4,000,000)

During fiscal 2001, the Company recorded $80,000 of deferred taxes relating to unrealized gains on available-for-sale securities presented in other comprehensive income in stockholders equity. During fiscal 2000, the Company recorded $448,000 of deferred taxes relating to unrealized gains on available-for-sale securities.

At June 30, 2001, the Company had net operating loss carry forwards for federal income tax purposes of approximately $250,000. All of the net operating loss carry forwards are attributable to Genderm Corporation, which the Company acquired through a taxable stock acquisition during fiscal 1998. The annual utilization of the net operating loss carryforward is limited for tax purposes under both the separate return limitation year rules and Internal Revenue Code sections 382 and 383.

During fiscal 2001, 2000 and 1999, the Company made tax payments of $8,233,000, $14,180,000 and $19,837,000 respectively.

Components of the provision for income taxes are as follows:

	JUNE 30,		
	2001	**2000**	**1999**
Current			
Federal	$18,503,000	$19,849,000	$30,561,000
State	986,000	1,564,000	3,415,000
Foreign	23,000	27,000	19,000

19,512,000	21,440,000	33,995,000
Deferred Federal		
(482,000)	2,768,000	(9,048,000)
State		
(125,000)	180,000	(744,000)
(607,000)	2,948,000	(9,792,000)
Total		
$18,905,000	$24,388,000	$24,203,000

Income tax expense for the three years ended June 30, 2001, 2000 and 1999 differs from the amount computed, applying the federal statutory rates as follows:

	JUNE 30,		
	2001	**2000**	**1999**
Statutory federal income tax rate	35.0%	35.0%	35.0%
State tax rate, net of federal benefit			
0.9	1.7	2.5	

Tax-exempt interest	(3.5)	(2.3) (2.0)
Other	(0.5)	1.8 1.4
	31.9%	36.2% 36.9%

NOTE 9. STOCK TRANSACTIONS

Class A Common Stock has one vote per share, and Class B Common Stock has 10 votes per share. Each share of Class B Common Stock may be converted into one share of Class A Common Stock at the option of the holder or, in some circumstances, may automatically be converted upon a vote of the Board of Directors and the majority of the Class B Common Stock shareholders.

In March 2001, the Company purchased approximately 300,000 shares of common stock at an average price of $33.13 in the open market under a stock repurchase program that was approved by the Company s Board of Directors in May 1999. This stock repurchase program provides for the repurchase of up to $75 million of Class A Common Stock at such times as management may determine.

On January 12, 1999, the Board of Directors declared a 3-for-2 stock split effected in the form of a 50% stock dividend payable February 16, 1999, to common shareholders of record at the close of business on January 29, 1999. Per share amounts and the weighted average number of shares outstanding have been retroactively revised for all periods presented.

In February 1998, the Company completed a public offering for 6,000,000 primary shares of the Company s Class A Common Stock at a price of $32.17 per share. The underwriters also exercised the over-allotment option of 510,000 primary shares at a price of $32.17 per share. Gross proceeds from the offering before related expenses totaled $209,405,000.

NOTE 10. STOCK OPTION PLANS

The Company has three active Stock Option Plans (the 1998, 1996 and 1995 Plans or, collectively, the Plans). As of June 30, 2001, the 1998, 1996 and 1995 Plans had the following options outstanding: 2,986,900; 1,711,210; and 169,515, respectively. The Plans allow the Company to designate options as qualified incentive or non-qualified on an as-needed basis. Qualified and non-qualified stock options vest over a period determined at the time the options are granted, ranging from one to five years. Options are granted at the fair market value on the grant date. Options outstanding at June 30, 2001, vary in price from $2.32 to $70.75, with a weighted average of $36.07 outlined in the following chart:

Range of	Number	Weighted Average Contractua	Weighted Average Exercise	Number	Weighted Average Exercise

Exercise Prices	Outstanding	Life	Price	Exercisable	Price
$2.32 - $12.11	149,358	4.99	$11.41	67,467	$10.56
$15.39 - $22.00					
1,419,544	7.98	$21.91	190,249	$21.39	
$22.22 - $28.50					
897,941	7.21	$24.51	281,118	$25.28	
$28.59 - $55.05					
579,632	6.92	$33.39	208,477	$31.82	
$55.25 - $55.25					
1,697,325	9.07	$55.25	0	$0.00	
$56.25 - $70.75					
123,825	9.27	$61.58	3,500	$57.10	

A summary of stock options granted within the Plans and related information for the years ended June 30, 2001, 2000 and 1999 is as follows:

	Qualified	Non-Qualified	Total	Weighted Average Price
Balance at June 30, 1998	1,264,499	1,289,533	2,554,032	$15.70
Granted				
718,023	703,103	1,421,126	$25.47	
Exercised				
(296,708)	(222,224)	(518,932)	$7.36	
Terminated/expired				
(191,854)	(15,525)	(207,379)	$25.63	
Balance at June 30, 1999				
1,493,960	1,754,887	3,248,847	$20.76	
Granted				
906,337	1,084,163	1,990,500	$23.31	
Exercised				
(366,789)	(461,152)	(827,941)	$12.27	
Terminated/expired				
(157,839)	(48,842)	(206,681)	$24.75	
Balance at June 30, 2000				
1,875,669	2,329,056	4,204,725	$23.45	

Granted
539,057 1,389,668 1,928,725 $55.57
Exercised
(350,757) (700,253) (1,051,010) $21.38
Terminated/expired
(167,270) (47,545) (214,815) $36.22

Balance at June 30, 2001
1,896,699 2,970,926 4,867,625 $36.07

Options exercisable under the Plans at June 30, 2001 were 750,811 with an average exercisable price of $24.94. During fiscal 2000 and 1999, 1,875 and 7,500 non-qualified stock options not subject to the Plans were exercised at a price of $6.47.

The Company elected the adoption of the disclosure-only provisions of SFAS No. 123 in fiscal 1998. In accordance with the provisions of SFAS No. 123, the Company applies APB No. 25 and related interpretations in accounting for option grants to employees under its stock option plans. If the Company had elected to recognize

compensation costs based upon the fair value of the options granted at grant date as prescribed by SFAS No. 123, operating results would have changed to the pro forma amounts indicated in the table below:

	2001	2000	1999
Net income as reported	$ 40,419,685	$ 42,994,182	$ 41,437,226
Net income pro forma $26,840,839 $35,641,156 $36,930,216 Diluted earnings Per common share as reported $1.28 $1.41 $1.41 Per common share pro forma $0.85 $1.17 $1.25			

The weighted average fair value of options granted during fiscal 2001, 2000 and 1999 was $16.62, $11.95 and $12.03, respectively.

Pro forma results disclosed are based upon the provisions of SFAS No. 123 using the Black-Scholes option pricing model and are not likely to be representative of the effect on pro forma net income for future years. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options, which, unlike options granted by the Company, have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company s stock options have characteristics significantly different from options traded on an exchange, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

	2001	2000	1999
Expected dividend yield	0.0%	0.0%	0.0%
Expected stock price volatility	0.5	0.5	0.5
Risk-free interest rate	5.0%	5.5%	5.5%
Expected life options	5 Years	5 Years	5 Years

NOTE 11. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	June 30,		
	2001	2000	1999
Numerator			
Net income	$40,419,685	$42,994,182	$41,437,226
Denominator for basic net income per common share	30,133,514	29,028,896	28,413,608
Effect of dilutive securities:			
Stock options	1,560,188	1,469,880	1,048,703

Denominator for diluted net income per common share	31,693,702	30,498,776	29,462,311
Basic net income per common share	$1.34	$1.48	$1.46
Diluted net income per common share	$1.28	$1.41	$1.41

The earnings per share computation for 2001 excludes 108,457 shares of stock because their effect would have been anti-dilutive.

NOTE 12. SIGNIFICANT CUSTOMERS

For fiscal 2001, three customers accounted for approximately 22.2%, 18.0% and 10.3% of net revenues. For fiscal 2000, four customers accounted for approximately 21.0%, 18.1%, 11.3% and 10.2% of net revenues. For fiscal 1999, two customers accounted for approximately 18.0% and 14.1% of net revenues.

NOTE 13. FINANCIAL INSTRUMENTS CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents, short-term investments and accounts receivable.

The Company maintains cash, cash equivalents and short-term investments primarily with two financial institutions that invest funds in short-term, interest-bearing, investment-grade, marketable securities. The Company performs periodic evaluations of the relative credit standing of these financial institutions.

At June 30, 2001 and 2000, three customers comprised approximately 54.5% and 57.8%, respectively, of accounts receivable. The Company does not require collateral from its customers, but performs periodic credit evaluations of its customers financial condition. Management does not believe a significant credit risk existed at June 30, 2001.

NOTE 14. DEFINED CONTRIBUTION PLAN

The Company has a defined contribution plan (the Contribution Plan) that is intended to qualify under Section 401(k) of the Internal Revenue Code. All employees, except those who have not attained the age of 21, are eligible to participate in the Contribution Plan. Participants may contribute, through payroll deductions, up to 20.0% of their basic compensation, not to exceed Internal Revenue Code limitations. Although the Contribution Plan provides for profit sharing contributions by the Company, the Company has not made any such contributions since its inception.

NOTE 15. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The table below lists the quarterly financial information for fiscal 2001 and 2000. All figures are in thousands, except per share data, and certain amounts do not total the annual amounts due to rounding.

	YEAR ENDED JUNE 30, 2001 (FOR THE QUARTERS ENDED)			
	SEPTEMBER 30, 2000	DECEMBER 31, 2000	MARCH 31, 2001	JUNE 30, 2001
Net revenues	$40,254	$ 41,367	$ 42,346	$ 43,834
Gross profit	32,775	33,575	34,876	35,879
Net income	517	12,737	13,302	13,864
Basic net income per common share	$0.02	$0.42	$0.44	$0.46
Diluted net income per common share	$0.02	$0.40	$0.42	$0.44

	YEAR ENDED JUNE 30, 2000 (FOR THE QUARTERS ENDED)			
	SEPTEMBER 30, 1999	DECEMBER 31, 1999	MARCH 31, 2000	JUNE 30, 2000
Net revenues	$31,644	$ 33,379	$ 35,049	$ 39,027
Gross profit	25,858	26,940	28,726	31,664
Net income	9,640	10,481	11,063	11,810
Basic net income per common share	$0.34	$0.36	$0.38	$0.40
Diluted net income per common share	$0.33	$0.35	$0.36	$0.38

Gross profit does not include amortization of the related intangibles.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

	Balance at	Charged to

Description	Balance at beginning of year	Additions charged to costs and expenses	Additions Charged to other accounts	Deductions	Balance at end of year
Year Ended June 30, 2001					
Deducted from Asset Accounts:					
Accounts Receivable:					
Allowances	$4,190,000	$860,000	$	$	$5,050,000
Year Ended June 30, 2000					
Deducted from Asset Accounts:					
Accounts Receivable:					
Allowances	3,815,000	375,000			4,190,000
Year Ended June 30, 1999					
Deducted from Asset Accounts:					
Accounts Receivable:					
Allowances	2,826,000	989,000			3,815,000

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
10.72(e)	Fourth amendment to Credit and Security Agreement, dated November 22, 2000 by and between the Company and Wells Fargo Bank Arizona, N.A., formerly known as Norwest Bank Arizona, N.A., as successor-in-interest to Norwest Business Credit, Inc.
23.1	Consent of Ernst & Young LLP, Independent Auditors