

MEDICIS PHARMACEUTICAL CORP

Form 10-Q

November 09, 2005

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

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

For the quarterly period ended September 30, 2005  
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 or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

8125 North Hayden Road  
Scottsdale, Arizona 85258-2463

(Address of principal executive offices)  
(602) 808-8800

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☐ NO

○  
Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2) YES ☐ NO ○

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2) YES ○ NO ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 3, 2005
Class A Common Stock \$.014 Par Value	54,404,052

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

	September 30, 2005 (unaudited)	June 30, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 250,338	\$ 177,785
Short-term investments	378,066	425,783
Accounts receivable, net	43,326	47,220
Inventories, net	19,700	20,701
Deferred tax assets, net	8,482	11,001
Other current assets	13,102	16,435
Total current assets	713,014	698,925
Property and equipment, net	5,812	6,143
Intangible assets:		
Intangible assets related to product line acquisitions and business combinations	326,780	326,780
Other intangible assets	4,787	4,507
	331,567	331,287
Less: accumulated amortization	77,350	71,749
Net intangible assets	254,217	259,538
Goodwill	64,672	64,672
Deferred financing costs, net	4,861	5,397
Other non-current assets	11,362	8,576
	\$ 1,053,938	\$ 1,043,251

See accompanying notes to condensed consolidated financial statements.

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

	September 30, 2005 (unaudited)	June 30, 2005
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	\$ 26,633	\$ 30,832
Short-term contract obligation	27,407	27,407
Income taxes payable	7,484	10,236
Other current liabilities	26,077	30,379
 Total current liabilities	 87,601	 98,854
 Long-term liabilities:		
Contingent convertible senior notes	453,065	453,065
Deferred tax liability, net	7,635	4,986
 <b>Stockholders Equity</b>		
Preferred stock, \$0.01 par value; shares authorized: 5,000,000; no shares issued		
Class A common stock, \$0.014 par value; shares authorized: 150,000,000; issued and outstanding: 67,037,580 and 67,007,330 at September 30, 2005 and June 30, 2005, respectively		
	938	938
Class B common stock, \$0.014 par value; shares authorized: 1,000,000; no shares issued and outstanding at September 30, 2005 and June 30, 2005		
Additional paid-in capital	548,070	539,443
Accumulated other comprehensive income	90	(606)
Deferred compensation		(697)
Accumulated earnings	299,269	288,474
Less: Treasury stock, 12,647,554 and 12,620,554 shares at cost at September 30, 2005 and June 30, 2005, respectively	(342,730)	(341,206)
 Total stockholders equity	 505,637	 486,346
	\$ 1,053,938	\$ 1,043,251

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	September 30, 2005	September 30, 2004
Net product revenues	\$ 79,398	\$ 72,107
Net contract revenues	3,866	16,711
Net revenues	83,264	88,818
Cost of product revenue (1)	12,024	13,833
Gross profit	71,240	74,985
Operating costs and expenses:		
Selling, general and administrative (2)	41,487	32,926
Research and development (3)	5,053	35,763
Depreciation and amortization	6,308	5,032
Operating costs and expenses	52,848	73,721
Operating income	18,392	1,264
Interest income	4,116	2,520
Interest expense	2,666	2,666
Income before income tax expense	19,842	1,118
Income tax expense	7,382	95
Net income	\$ 12,460	\$ 1,023
Basic net income per common share	\$ 0.23	\$ 0.02
Diluted net income per common share	\$ 0.20	\$ 0.02

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Cash dividend declared per common share	\$ 0.03	\$ 0.03
Basic common shares outstanding	54,310	57,228
Diluted common shares outstanding	69,850	60,268

(1) amounts exclude amortization of intangible assets related to acquired products	\$ 5,560	\$ 4,432
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(2) amounts include share-based compensation expense	\$ 7,184	\$ 129
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(3) amounts include share-based compensation expense	\$ 505	
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See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	September 30, 2005	September 30, 2004
<b>Operating Activities:</b>		
Net income	\$ 12,460	\$ 1,023
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,844	5,568
Loss on disposal of property and equipment	31	37
Loss on sale of available-for-sale investments	599	20
Share-based compensation expense	7,689	129
Deferred income tax expense (benefit)	5,169	(5,185)
Tax benefit from exercise of stock options	30	2,616
Excess tax benefits from exercise of stock options	(72)	
Provision for doubtful accounts and returns	(4,862)	300
Accretion of premium on investments	17	1,308
Changes in operating assets and liabilities:		
Accounts receivable	8,757	1,776
Inventories	1,001	(81)
Other current assets	3,332	2,114
Accounts payable	(5,838)	4,611
Income taxes payable	(2,753)	3,381
Other current liabilities	(4,338)	(3,711)
Net cash provided by operating activities	28,066	13,906
<b>Investing Activities:</b>		
Purchase of property and equipment	(408)	(1,002)
Payment of direct merger costs	(1,147)	(25)
Payment for purchase of product rights	(280)	(578)
Purchase of available-for-sale investments	(110,453)	(297,629)
Sale of available-for-sale investments	94,762	380,033
Maturity of available-for-sale investments	63,224	15,655
Net cash provided by investing activities	45,698	96,454
<b>Financing Activities:</b>		
Payment of dividends	(1,629)	(1,435)
Purchase of treasury stock		(65,855)
Excess tax benefits from exercise of stock options	72	
Proceeds from the exercise of stock options	81	8,208
Net cash used in financing activities	(1,476)	(59,082)

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Effect of exchange rate on cash and cash equivalents	265	510
Net increase in cash and cash equivalents	72,553	51,788
Cash and cash equivalents at beginning of period	177,785	46,621
Cash and cash equivalents at end of period	\$ 250,338	\$ 98,409

See accompanying notes to condensed consolidated financial statements.

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**MEDICIS PHARMACEUTICAL CORPORATION**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2005**  
**(unaudited)**

**1. NATURE OF BUSINESS**

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

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

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

On March 20, 2005, Medicis, Masterpiece Acquisition Corp. (a wholly-owned subsidiary of Medicis), and Inamed Corporation ( Inamed ) entered into an Agreement and Plan of Merger. Inamed is a global healthcare company that develops, manufactures, and markets a diverse line of products that enhance the quality of people s lives. These products include breast implants for aesthetic augmentation and reconstructive surgery following a mastectomy, a range of dermal products to correct facial wrinkles, the BioEnterics<sup>®</sup> LAP-BAND<sup>®</sup> System designed to treat severe and morbid obesity, and the BioEnterics<sup>®</sup> IntraGastric Balloon (BIB<sup>®</sup>) system for the treatment of obesity. Inamed s common stock trades on the NASDAQ National Market under the symbol IMDC. The completion of the transaction is subject to several customary conditions. See Note 4.

The consolidated financial statements include the accounts of Medicis Pharmaceutical Corporation and its wholly owned subsidiaries ( Medicis or the Company ). The Company does not have any subsidiaries in which it does not own 100% of the outstanding stock. All of the Company s subsidiaries are included in the consolidated financial statements. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying interim condensed consolidated financial statements of Medicis have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2005 ( fiscal 2005 ), except for the adoption of Statement of Financial Accounting Standards No. 123R, Share-Based Payment ( SFAS No. 123R ) See Note 2. The financial information is unaudited but reflects all adjustments, consisting only of normal recurring accruals, which are, in the opinion of the Company s management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the Company s Annual Report on Form 10-K for fiscal 2005. Certain prior period amounts have been reclassified to conform with current period presentation.

**Table of Contents****2. SHARE-BASED COMPENSATION**

At September 30, 2005, the Company had six active share-based employee compensation plans. Stock option awards granted from these plans are granted at the fair market value on the date of grant, and vest over a period determined at the time the options are granted, ranging from one to five years, and generally have a maximum term of ten years. Certain options provide for accelerated vesting if there is a change in control (as defined in the plans). When options are exercised, new shares of the Company's Class A common stock are issued. Prior to July 1, 2005, the Company accounted for share-based employee compensation, including stock options, using the method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations (APB Opinion No. 25). Under APB Opinion No. 25, stock options are granted at market price and no compensation cost is recognized, and a disclosure is made regarding the pro forma effect on net earnings assuming compensation cost had been recognized in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). During December 2004, the FASB issued SFAS No. 123R, which requires companies to measure and recognize compensation expense for all share-based payments at fair value. SFAS No. 123R eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, and generally requires that such transactions be accounted for using prescribed fair-value-based methods. SFAS No. 123R permits public companies to adopt its requirements using one of two methods: (a) a modified prospective method in which compensation costs are recognized beginning with the effective date based on the requirements of SFAS No. 123R for all share-based payments granted or modified after the effective date, and based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date or (b) a modified retrospective method which includes the requirements of the modified prospective method described above, but also permits companies to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either for all periods presented or prior interim periods of the year of adoption. Effective July 1, 2005, the Company adopted SFAS No. 123R using the modified prospective method. Other than restricted stock, no share-based employee compensation cost has been reflected in net income prior to the adoption of SFAS No. 123R. Results for prior periods have not been restated.

The adoption of SFAS No. 123R reduced income before income tax expense for the three months ended September 30, 2005 by approximately \$7.4 million and reduced net income for the three months ended September 30, 2005 by approximately \$4.9 million. Basic and diluted net income per common share for the three months ended September 30, 2005 would have been \$0.32 and \$0.27, respectively, if the Company had not adopted SFAS No. 123R, compared to reported basic and diluted net income per common share of \$0.23 and \$0.20, respectively. The total value of the stock options awards is expensed ratably over the service period of the employees receiving the awards. As of September 30, 2005, total unrecognized compensation cost related to stock option awards was approximately \$71.5 million and the related weighted-average period over which it is expected to be recognized is approximately 3.1 years.

Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the condensed consolidated statements of cash flows. SFAS No. 123R requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The \$0.1 million excess tax benefit classified as a financing cash inflow in the Company's accompanying condensed consolidated statements of cash flows for the three months ended September 30, 2005 would have been classified as an operating cash inflow if the Company had not adopted SFAS No. 123R.

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A summary of stock options activity within the Company's share-based compensation plans and changes for the three months ended September 30, 2005 is as follows:

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Balance at June 30, 2005	13,648,378	\$ 26.89		
Granted	843,550	\$ 32.43		
Exercised	(3,250)	\$ 24.76		
Terminated/expired	(61,461)	\$ 30.27		
Balance at September 30, 2005	14,427,217	\$ 27.20	6.8	\$ 93,334,580

The intrinsic value of options exercised during the three months ended September 30, 2005 was \$30,683. Options exercisable under the Company's share-based compensation plans at September 30, 2005 were 7,283,726, with an average exercise price of \$24.23, an average remaining contractual term of 5.7 years, and an aggregate intrinsic value of \$63,577,619.

The fair value of each stock option award is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	<b>Three Months Ended September 30, 2005</b>	<b>Three Months Ended September 30, 2004</b>
Expected dividend yield	0.4%	0.3%
Expected stock price volatility	0.36	0.44
Risk-free interest rate	4.1% to 4.2%	3.6%
Expected life of options	6 to 8 Years	5 Years

The expected dividend yield is based on expected annual dividend to be paid by the Company as a percentage of the market value of the Company's stock as of the date of grant. The Company determined that a blend of implied volatility and historical volatility is more reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The risk-free interest rate is based on the U.S. treasury security rate in effect as of the date of grant. The expected lives of options are based on historical data of the Company.

The weighted average fair value of stock options granted during the three months ended September 30, 2005 and 2004 was \$14.15 and \$16.08, respectively.

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The following table illustrates the effect on net income (loss) and net income (loss) per common share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to all outstanding stock option awards for periods presented prior to the Company's adoption of SFAS No. 123R (amounts in thousands, except per share amounts):

	<b>THREE MONTHS ENDED SEPTEMBER 30, 2004</b>
Net income, as reported	\$ 1,023
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	4,899
Pro-forma net loss	\$ (3,876)
Net income (loss) per common share:	
Basic, as reported	\$ 0.02
Basic, pro forma	\$ (0.07)
Diluted, as reported	\$ 0.02
Diluted, pro forma	\$ (0.07)

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company's Class A common stock on the date of grant, and the total value of the award is expensed ratably over the service period of the employees receiving the grants. During the three months ended September 30, 2005, 147,710 shares of restricted stock were granted to certain employees. Share-based compensation expense related to all restricted stock awards outstanding during the three months ended September 30, 2005 and 2004, was approximately \$0.3 million and \$0.1 million, respectively. As of September 30, 2005, the total amount of unrecognized compensation cost related to nonvested restricted stock awards was approximately \$5.1 million, and the related weighted-average period over which it is expected to be recognized is approximately 4.4 years.

A summary of restricted stock activity within the Company's share-based compensation plans and changes for the three months ended September 30, 2005 is as follows:

<b>Nonvested Shares</b>	<b>Shares</b>	<b>Weighted- Average Grant-Date Fair Value</b>
Nonvested at June 30, 2005	92,000	\$ 23.41
Granted	147,710	\$ 32.41
Vested	(27,000)	\$ 23.44
Forfeited		\$
Nonvested at September 30, 2005	212,710	\$ 29.65

The total fair value of restricted shares vested during the three months ended September 30, 2005 and 2004 was \$0.6 million and \$0.4 million, respectively.

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**3. RESEARCH AND DEVELOPMENT COSTS AND ACCOUNTING FOR STRATEGIC COLLABORATIONS**

All research and development costs, including payments related to products under development and research consulting agreements, are expensed as incurred. The Company may continue to make up-front, non-refundable payments to third parties for new technologies and for research and development work that has been completed. These up-front payments may be expensed at the time of payment depending on the nature of the payment made.

The Company's policy on accounting for costs of strategic collaborations determines the timing of the recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or capitalized as an asset. Management is required to form judgments with respect to the commercial status of such products in determining whether development costs meet the criteria for immediate expense or capitalization. For example, when the Company acquires certain products for which there is already an Abbreviated New Drug Application (ANDA) or a New Drug Application (NDA) available, and there is net realizable value based on projected sales for these products, the Company capitalizes the amount paid as an intangible asset. In addition, if the Company acquires product rights that are in the development phase and as to which the Company has no assurance that the third party is required to perform additional research efforts, the Company expenses such payments.

On July 15, 2004, the Company entered into an exclusive license agreement and other ancillary documents with Q-Med to market, distribute, sell and commercialize in the U.S. and Canada Q-Med's product currently known as SubQ™. Q-Med has the exclusive right to manufacture SubQ™ for Medicis. SubQ™ is currently not approved for use in the U.S. or Canada. Under terms of the agreement, Medicis Aesthetics Holdings Inc., a wholly owned subsidiary of Medicis, licenses SubQ™ for approximately \$80 million, due as follows: approximately \$30 million on July 15, 2004, which was recorded as a charge to research and development expense during the first quarter of fiscal 2005; approximately \$10 million upon completion of certain clinical milestones; approximately \$20 million upon satisfaction of certain defined regulatory milestones; and approximately \$20 million upon U.S. launch of SubQ™. In addition, the Company incurred approximately \$0.7 million of professional fees related to the completion of the agreements during the first quarter of fiscal 2005, which was included in selling, general and administrative expenses. The Company also will make additional milestone payments to Q-Med upon the achievement of certain commercial milestones.

**4. DEFINITIVE MERGER AGREEMENT WITH INAMED**

On March 20, 2005, Medicis, Masterpiece Acquisition Corp. (a wholly-owned subsidiary of Medicis), and Inamed entered into an Agreement and Plan of Merger. Inamed is a global healthcare company that develops, manufactures, and markets a diverse line of products that enhance the quality of people's lives. These products include breast implants for aesthetic augmentation and reconstructive surgery following a mastectomy, a range of dermal filler products to correct facial wrinkles, the BioEnterics® LAP-BAND® System designed to treat severe and morbid obesity, and the BioEnterics® Intragastric Balloon (BIB®) system for the treatment of obesity. Inamed's common stock trades on the NASDAQ National Market under the symbol IMDC.

Under the terms of the Agreement and Plan of Merger, Inamed will merge with and into Masterpiece Acquisition Corp. and each share of Inamed common stock will be converted into the right to receive 1.4205 shares of Medicis common stock and \$30.00 in cash. The completion of the transaction is subject to several customary conditions, including the receipt of applicable approvals from Medicis and Inamed's stockholders, the absence of any material adverse effect on either party's business and the receipt of regulatory approvals. The discussions in this report relate to Medicis as a stand-alone entity and do not include or reflect the operating results of Inamed or the impact of the proposed merger with Inamed following the closing of the transaction.

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The Company has incurred approximately \$11.4 million of professional and other costs related to the transaction. The costs are included in other non-current assets in the accompanying consolidated balance sheets. Business integration costs related to the transaction, including the planning for and implementation of integration activities, are being expensed as incurred. During the first quarter of fiscal 2006, the Company incurred approximately \$0.7 million of business integration planning costs, which are included in selling, general and administrative expenses in the accompanying consolidated statements of income.

Restrictions in the merger agreement on solicitation generally prohibit the Company from soliciting any acquisition proposal or offer for a merger or business combination with any other party, including a proposal that might be advantageous to its stockholders when compared to the terms and conditions of the merger with Inamed. If the merger is not completed, the Company may not be able to conclude another merger, sale or combination on as favorable terms, in a timely manner, or at all. If the merger agreement is terminated, the Company, in certain specified circumstances, may be required to pay a termination fee of up to \$70.0 million to Inamed. In addition, under certain circumstances, the Company may be required to pay Inamed an expense fee or regulatory termination fee of \$10.0 million. As consideration for Inamed's dismissal of pending litigation against Medicis, the Company agreed to pay Inamed an aggregate of \$16.5 million if either the \$70.0 million termination fee or the \$10.0 million expense fee becomes payable by Medicis or if the merger agreement is terminated because its stockholder approval is not obtained at the stockholders meeting relating to the merger. If the transaction is terminated as a result of Inamed's stockholders voting against the adoption of the merger agreement, these fees will not be payable by Medicis.

The Agreement and Plan of Merger was filed with the SEC by the Company as part of a Current Report on Form 8-K filed on March 21, 2005. A Registration Statement on Form S-4 relating to the Inamed merger was filed with the SEC on November 2, 2005.

**5. LICENSE OF PRODUCTS TO TARO PHARMACEUTICAL INDUSTRIES, INC.**

On July 27, 2004, the Company entered into an exclusive license and optional purchase agreement with Taro Pharmaceutical Industries, Inc. ( Taro ) pursuant to which Taro will market, distribute and sell the LUSTRA® family of products and two development stage products in the U.S., Canada and Puerto Rico. The LUSTRA® family of products are topical therapies prescribed for the treatment of ultraviolet-induced skin discolorations and hyperpigmentation usually associated with the use of oral contraceptives, pregnancy, hormone replacement therapy, sun damage and superficial trauma. The license agreement extends through July 1, 2007, after which Taro may purchase the product lines.

**6. LICENSE OF ORAPRED® TO BIOMARIN**

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

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Under terms of the original agreements, BioMarin was to make license payments to Ascent of approximately \$93 million payable over a five-year period as follows: approximately \$10 million as of the date of the transaction; approximately \$12.5 million per quarter for four quarters beginning in July 2004; approximately \$2.5 million per quarter for the subsequent four quarters beginning in July 2005; approximately \$2 million per quarter for the subsequent eight quarters beginning in July 2006; and approximately \$1.75 million per quarter for the last four quarters of the five-year period beginning in July 2008. BioMarin was also to make payments of \$2.5 million per quarter for six quarters beginning in July 2004 for reimbursement of certain contingent payments as discussed in Note 8. The license agreement will terminate in July 2009. At that time, based on certain conditions, BioMarin would have the option to purchase all outstanding shares of Ascent for approximately \$82 million. The payment was to consist of \$62 million in cash and \$20 million in BioMarin common stock, based on the fair value of the stock at that time. The Company was responsible for the manufacture and delivery of finished goods inventory to BioMarin, and BioMarin was responsible for paying the Company for finished goods inventory delivered through June 30, 2005. As a result, the Company was required to recognize the first \$60 million of license payments ratably through June 30, 2005. The license payments received after June 30, 2005 and the reimbursement of contingent payments will be recognized as revenue when all four criteria of SAB 104 have been met.

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

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

Additionally, per the terms of the Agreements, Medicis has made available to BioMarin the ability to draw down on a Convertible Note up to \$25 million beginning July 1, 2005. The Convertible Note is convertible based on certain terms and conditions including a change of control provision. Money advanced under the Convertible Note is convertible into BioMarin shares at a strike price equal to the BioMarin average closing price for the 20 trading days prior to such advance. The Convertible Note matures on the option purchase date in 2009 as defined in the Securities Purchase Agreement but may be repaid by BioMarin at any time prior to the option purchase date. No monies have been advanced to-date. In conjunction with the Agreements, BioMarin and Medicis have entered into a settlement and Mutual Release Agreement to forever discharge each other from any and all claims, demands, damages, debts, liabilities, actions and causes of action relating to the transaction consummated by the parties other than certain continuing obligations in accordance with the terms of the parties agreements. As of September 30, 2005, BioMarin had paid \$72.1 million to Medicis under the license agreement, which represents all scheduled payments due through that date under the license agreement.

**Table of Contents****7. ACQUISITION OF DERMAL AESTHETIC ENHANCEMENT PRODUCTS FROM THE Q-MED GROUP**

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

**8. MERGER OF ASCENT PEDIATRICS, INC.**

As part of its merger with Ascent completed in November 2001, the Company may be required to make contingent purchase price payments ( Contingent Payments ) for each of the first five years following closing based upon reaching certain sales threshold milestones on the Ascent products for each twelve month period through November 15, 2006, subject to certain deductions and set-offs. From time to time the Company assesses the probability and likelihood of payment in the coming respective November period based on current sales trends. There can be no assurance that such payment will ultimately be made nor is the accrual of a liability an indication of current sales levels. A total of approximately \$27.4 million is included in short-term contract obligation in the Company's condensed consolidated balance sheets as of September 30, 2005, representing the first three years' Contingent Payments. Pursuant to the merger agreement, payment of the contingent portion of the purchase price will be withheld pending the final outcome of the litigation discussed in Part II of this Form 10-Q.

**9. SEGMENT AND PRODUCT INFORMATION**

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

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

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

	<b>THREE MONTHS ENDED SEPTEMBER 30, 2005</b>		<b>2004</b>
Acne and acne-related dermatological products	33%		31%
Non-acne dermatological products	56		45
Non-dermatological products	11		24

Total net revenues

100%

100%

14

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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 raw materials and components at the manufacturers' facilities, and are valued at the lower of cost or market using the first-in, first-out method. The Company provides valuation reserves for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions.

Inventories at September 30, 2005 and June 30, 2005 are as follows (amounts in thousands):

	September 30, 2005	June 30, 2005
Raw materials	\$ 4,829	\$ 5,283
Finished goods	15,867	16,518
Valuation reserve	(996)	(1,100)
Total inventories	\$ 19,700	\$ 20,701

**11. CONTINGENT CONVERTIBLE SENIOR NOTES**

In June 2002, the Company sold \$400.0 million aggregate principal amount of its 2.5% Contingent Convertible Notes Due 2032 (the "Old Notes") in private transactions. As discussed below, approximately \$230.8 million in principal amount of the Old Notes was exchanged for New Notes on August 14, 2003. The Old Notes bear interest at a rate of 2.5% per annum, which is payable on June 4 and December 4 of each year, beginning on December 4, 2002. The Company also agreed to pay contingent interest at a rate equal to 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2007, if the average trading price of the Old Notes reaches certain thresholds. The Old Notes will mature on June 4, 2032.

The Company may redeem some or all of the Old Notes at any time on or after June 11, 2007, at a redemption price, payable in cash, of 100% of the principal amount of the Old Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the Old Notes may require the Company to repurchase all or a portion of their Old Notes on June 4, 2007, 2012 and 2017; and upon a change in control, as defined in the indenture governing the Old Notes, at 100% of the principal amount of the Old Notes, plus accrued and unpaid interest to the date of the repurchase, payable in cash.

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

during any quarter commencing after June 30, 2002, if the closing price of the Company's Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 110% of the conversion price of the Old Notes, or \$31.96. The Old Notes are initially convertible at a conversion price of \$29.05 per share, which is equal to a conversion rate of approximately 34.4234 shares per \$1,000 principal amount of Old Notes, subject to adjustment;

if the Company has called the Old Notes for redemption;

during the five trading day period immediately following any nine consecutive day trading period in which the trading price of the Old Notes per \$1,000 principal amount for each day of such period was less than 95% of the product of the closing sale price of the Company's Class A common stock on that day multiplied by the number of shares of the Company's Class A common stock issuable upon conversion of \$1,000 principal amount of the Old Notes; or

upon the occurrence of specified corporate transactions.

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

The Company incurred \$12.6 million of fees and other origination costs related to the issuance of the Old Notes. The Company is amortizing these costs over the five-year Put period, which runs through May 2007. The Put period runs from the date the Old Notes were issued to the date the Company may redeem some or all of the Old Notes.

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

The New Notes bear interest at a rate of 1.5% per annum, which is payable on June 4 and December 4 of each year, beginning December 4, 2003. The Company will also pay contingent interest at a rate of 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2008, if the average trading price of the New Notes reaches certain thresholds. The New Notes mature on June 4, 2033.

The Company may redeem some or all of the New Notes at any time on or after June 11, 2008, at a redemption price, payable in cash, of 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the New Notes may require the Company to repurchase all or a portion of their New Notes on June 4, 2008, 2013 and 2018, and upon a change in control, as defined in the indenture governing the New Notes, at 100% of the principal amount of the New Notes, plus accrued and unpaid interest to the date of the repurchase, payable in cash.

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

during any quarter commencing after September 30, 2003, if the closing price of the Company's Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 120% of the conversion price of the New Notes, or \$46.51. The Notes are initially convertible at a conversion price of \$38.76 per share, which is equal to a conversion rate of approximately 25.7998 shares per \$1,000 principal amount of New Notes, subject to adjustment;

if the Company has called the New Notes for redemption;

during the five trading day period immediately following any nine consecutive day trading period in which the trading price of the New Notes per \$1,000 principal amount for each day of such period was less than 95% of the product of the closing sale price of the Company's Class A common stock on that day multiplied by the number of shares of the Company's Class A common stock issuable upon conversion of \$1,000 principal amount of the New Notes; or

upon the occurrence of specified corporate transactions.

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

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As a result of the exchange, the outstanding principal amounts of the Old Notes and the New Notes were \$169.2 million and \$283.9 million, respectively. Both the New Notes and Old Notes are reported in aggregate on the Company's condensed consolidated balance sheets. The Company incurred approximately \$5.1 million of fees and other origination costs related to the issuance of the New Notes. The Company is amortizing these costs over the five-year Put period, which runs through August 2008. The Put period runs from the date the New Notes were issued to the date the Company may redeem some or all of the New Notes.

During the quarters ended September 30, 2005, December 31, 2004, September 30, 2004, June 30, 2004, March 31, 2004 and December 31, 2003, the Old Notes met the criteria for the right of conversion into shares of the Company's Class A common stock. This right of conversion of the holders of Old Notes was triggered by the stock closing above \$31.96 on 20 of the last 30 trading days and the last trading day of the quarters ended September 30, 2005, December 31, 2004, September 30, 2004, June 30, 2004, March 31, 2004 and December 31, 2003. The holders of Old Notes have this conversion right only until December 31, 2005. During the quarters ended June 30, 2005 and March 31, 2005, the Old Notes did not meet the criteria for the right of conversion. At the end of all future quarters, the conversion rights will be reassessed in accordance with the bond indenture agreement to determine if the conversion trigger rights have been achieved. During the three months ended September 30, 2004 and March 31, 2004, outstanding principal amounts of \$2,000 and \$6,000 of Old Notes, respectively, were converted into shares of the Company's Class A common stock. As of November 8, 2005, no other Old Notes had been converted.

**12. INCOME TAXES**

Income taxes have been provided for using the liability method in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes. The provision for income taxes reflects management's estimate of the effective tax rate expected to be applicable for the full fiscal year. This estimate is re-evaluated by management each quarter based on the Company's estimated tax expense for the year.

At September 30, 2005, the Company has a federal net operating loss carryforward of approximately \$62.9 million that begins expiring in varying amounts in the years 2008 through 2021 if not previously utilized. The net operating loss carryforward was acquired in connection with the Company's merger with Ascent during fiscal 2002. As a result of the merger and related ownership change for Ascent, the annual utilization of the net operating loss carryforward is limited under Internal Revenue Code Section 382. Based upon this limitation, the Company estimates that approximately \$16.7 million of the \$62.9 million net operating loss carryforward will be realized. Accordingly, a valuation reserve has been recorded for the remaining net operating loss carryforward that is not expected to be realized.

At September 30, 2005, the Company had a research and experimentation credit carryforward of approximately \$1.3 million that begins expiring in varying amounts in the years 2008 through 2021 if not previously utilized. All of the research and experimentation credit carryforward was acquired in connection with the Company's merger with Ascent during fiscal 2002 and is subject to the limitation under Internal Revenue Code Section 383. As a result of this limitation, the Company does not expect to realize any of the research and experimentation credits acquired from Ascent. Accordingly, a valuation reserve of \$1.3 million has been established for the acquired research and experimentation credits.

As a result of the limitations described above, the Company recorded a deferred tax asset valuation allowance of \$17.5 million related to the net operating loss and research and experimentation credit carryforwards acquired in the merger with Ascent. Subsequent realization of loss and credit carryforwards in excess of the amounts estimated to be realized as of September 30, 2005 will be applied to reduce the valuation allowance and goodwill recorded in connection with the merger with Ascent.

The Company benefited from additional tax deductions available relating to the vesting of restricted stock and the exercise of employee stock options. Accordingly, the Company recorded a \$0.1 million increase to equity with a corresponding \$0.1 million reduction in taxes payable for the three months ended September 30, 2005. Quarterly adjustments for the tax deductions relating to share-based payments may vary as they relate to the actions of the option holder or shareholder.

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**13. STOCK TRANSACTIONS**

During September 2004, all 758,032 shares of the Company's Class B common stock were exchanged for 758,032 shares of the Company's Class A common stock. As of September 30, 2005, there were no shares of Class B common stock outstanding.

During the three months ended September 30, 2004, Medicis purchased 1,743,800 shares of its Class A common stock in the open market at an average price of \$37.76 per share. These stock purchases were made in accordance with a stock repurchase program that was approved by the Company's Board of Directors in August 2004. This program provided for the repurchase of up to \$150 million of Class A common stock at such times as management determined. As of September 30, 2005, the Company had repurchased a total of approximately \$150.0 million of Class A common stock pursuant to this program, all during the six months ended December 31, 2004. As the purchase limit had been reached, the plan was terminated. During the three months ended September 30, 2005, Medicis did not purchase any of its shares of Class A common stock. The timing and amount of any future repurchases will depend on market conditions and corporate considerations.

**14. DIVIDENDS DECLARED ON COMMON STOCK**

On September 14, 2005, the Company declared a cash dividend of \$0.03 per issued and outstanding share of its Class A common stock payable on October 31, 2005 to stockholders of record at the close of business on October 3, 2005. The \$1.7 million dividend was recorded as a reduction of accumulated earnings and is included in other current liabilities in the accompanying condensed consolidated balance sheets as of September 30, 2005.

**15. COMPREHENSIVE INCOME**

Total comprehensive income includes net income and other comprehensive income, which consists of foreign currency translation adjustments and unrealized gains and losses on available-for-sale investments. Total comprehensive income for the three months ended September 30, 2005 was \$13.2 million. Total comprehensive income for the three months ended September 30, 2004 was \$2.2 million.

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

	<b>Three Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>BASIC</b>		
Net income	\$ 12,460	\$ 1,023
Weighted average number of common shares outstanding	54,310	57,228
Basic net income per common share	\$ 0.23	\$ 0.02
<b>DILUTED</b>		
Net income	\$ 12,460	\$ 1,023
Add:		
Tax-effected interest expense and issue costs related to Old Notes	841	839
Tax-effected interest expense and issue costs related to New Notes	839	838
Net income assuming dilution	\$ 14,140	\$ 2,700
Weighted average number of common shares	54,310	57,228
Effect of dilutive securities:		
Old Notes	5,823	
New Notes	7,325	
Stock options and restricted stock	2,392	3,040
Weighted average number of common Shares assuming dilution	69,850	60,268
Diluted net income per common share	\$ 0.20	\$ 0.02

Diluted net income per common share must be calculated using the if-converted method in accordance with EITF 04-8, Effect of Contingently Convertible Debt on Earnings per Share. Diluted net income per share is calculated by adjusting net income for tax-effected net interest and issue costs on the Old Notes and New Notes, divided by the weighted average number of common shares outstanding assuming conversion. Prior year results have been restated to conform to EITF 04-8.

The diluted net income per common share computation for the three months ended September 30, 2005 excludes 5,501,851 shares of stock that represented outstanding stock options that were anti-dilutive.



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The diluted net income per common share computation for the three months ended September 30, 2004 excludes 2,183,362 shares of stock that represented outstanding stock options that were anti-dilutive. Diluted net income per common share for the three months ended September 30, 2004 also excludes 5,822,960 and 7,324,820 shares of Class A common stock, respectively, issuable upon conversion of the Old Notes and New Notes, as they were anti-dilutive.

**17. SUBSEQUENT EVENT**

On October 31, 2005, the Company made a development milestone payment of approximately \$8.0 million to Dow Pharmaceutical Sciences, Inc. ( Dow ) under an amended development and license agreement for the development and commercialization of a patented dermatologic product. This payment will be recorded as a charge to research and development expense during the three months ended December 31, 2005.

**18. CONTINGENCIES**

The Company and certain of its subsidiaries are parties to actions and proceedings incident to their businesses, including litigation regarding its intellectual property, challenges to the enforceability or validity of its intellectual property and claims that its products infringe on the intellectual property rights of others. Although the outcome of these actions is not presently determinable, it is the opinion of the Company's management, based upon the information available at this time, the litigation is either covered by insurance and/or established reserves, or in some cases rights of offset and/or indemnification, and that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the results of operations or financial condition of the Company.

**19. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In October 2004, the FASB ratified the consensus reached by the EITF on Issue 04-1, *Accounting for Preexisting Relationships between the Parties to a Business Combination*, EITF No. 04-1 requires that a business combination between two parties that have a preexisting relationship be evaluated to determine if a settlement of a preexisting relationship exists. EITF No. 04-1 also requires that certain reacquired rights (including the rights to the acquirer's trade name under a franchise agreement) be recognized as intangible assets apart from goodwill. However, if a contract giving rise to the reacquired rights includes terms that are favorable or unfavorable when compared to pricing for current market transactions for the same or similar items, EITF No. 04-1 requires that a settlement gain or loss should be measured as the lesser of a) the amount by which the contract is favorable or unfavorable under market terms from the perspective of the acquirer or b) the stated settlement provisions of the contract available to the counterparty to which the contract is unfavorable.

EITF No. 04-1 is effective prospectively for business combinations consummated in reporting periods beginning after October 13, 2004. EITF No. 04-1 will apply to the merger with Inamed. The amount and timing of any such gains or losses the Company might record is dependent upon what the Company acquires and when the merger is consummated. The Company currently expects to record a charge of \$16.5 million related to the settlement of certain litigation with Inamed.

In October 2005, the FASB issued FASB Staff Position ( FSP ) No. 123R-2, *Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123R*, to provide guidance on determining the grant date for an award as defined in SFAS No. 123R. This FSP stipulates that assuming all other criteria in the grant date definition are met, a mutual understanding of the key terms and conditions of an award to an individual employee is presumed to exist upon the award's approval in accordance with the relevant corporate governance requirements, provided that the key terms and conditions of an award (a) cannot be negotiated by the recipient with the employer because the award is a unilateral grant, and (b) are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. The Company has applied the principles set forth in this FSP upon its adoption of SFAS No. 123R.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**EXECUTIVE SUMMARY**

We are a leading specialty pharmaceutical company focusing primarily on helping patients attain a healthy and youthful appearance and self-image through the development and marketing of products in the U.S. for the treatment of dermatological, aesthetic and podiatric conditions. We also market products in Canada for the treatment of dermatological and aesthetic conditions. We offer a broad range of products addressing various conditions or aesthetics improvements, including dermal fillers, acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, eczema, skin and skin-structure infections, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin).

Our current product lines are divided between the Dermatological and Non-dermatological fields. The Dermatological field represents products for the treatment of Acne and Acne-related dermatological conditions and Non-acne dermatological conditions. The Non-dermatological field represents products for the treatment of Urea Cycle Disorder and contract revenue. Our Acne and Acne-related dermatological product lines include core brands DYNACIN<sup>®</sup>, PLEXION<sup>®</sup> and TRIAZ<sup>®</sup>. Our Non-acne dermatological product lines include core brands LOPROX<sup>®</sup>, OMNICEF<sup>®</sup>, RESTYLANE<sup>®</sup> and VANOS. The Non-dermatological product lines include AMMONUL<sup>®</sup> and BUPHENYL<sup>®</sup>. Our Non-dermatological field also includes contract revenues associated with licensing agreements and authorized generic agreements.

**Key Aspects of Our Business**

We derive a majority of our prescription volume from our core prescription products. We believe that sales of our core prescription products and sales of our dermal aesthetic product, RESTYLANE<sup>®</sup>, which we began selling in the U.S. on January 6, 2004, will continue to constitute a significant portion of our sales for the foreseeable future.

We have built our business by executing a four-part growth strategy. This strategy consists of promoting existing core brands, developing new products and important product line extensions, entering into strategic collaborations and acquiring complementary products, technologies and businesses.

As a result of customer buying patterns, a substantial portion of our revenues has been recognized in the last month of each quarter. We schedule our inventory purchases to meet anticipated customer demand. As a result, relatively small delays in the receipt of manufactured products by us could result in revenues being deferred or lost. Our operating expenses are based upon anticipated sales levels, and a high percentage of our operating expenses are relatively fixed in the short term. Consequently, variations in the timing of revenue recognition could cause significant fluctuations in operating results from period to period and may result in unanticipated periodic earnings shortfalls or losses.

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

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We sell our products primarily to major wholesalers and retail pharmacy chains. Consistent with pharmaceutical industry patterns, approximately 80% of our revenues are derived from three major drug wholesale concerns. While we attempt to estimate inventory levels of our products at our major wholesale customers, using historical prescription information and historical purchase patterns, this process is inherently imprecise. Rarely do wholesale customers provide us complete inventory levels at regional distribution centers, or within their national distribution systems. We rely wholly upon our wholesale and drug chain customers to effect the distribution allocation of our products. Based upon historically consistent purchasing patterns of our major wholesale customers, we believe our estimates of trade inventory levels of our products are reasonable. We further believe that inventories of our products among wholesale customers, taken as a whole, are similar to those of other specialty pharmaceutical companies, and that our trade practices, which periodically involve volume discounts and early payment discounts, are typical of the industry.

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

We cannot control or significantly influence the purchasing patterns of our wholesale and retail drug chain customers. They are highly sophisticated customers that purchase products in a manner consistent with their industry practices and, presumably, based upon their projected demand levels. Purchases by any given customer, during any given period, may be above or below actual prescription volumes of any of our products during the same period, resulting in fluctuations of product inventory in the distribution channel.

As described in more detail below, the following significant events and transactions occurred during the three months ended September 30, 2005 and affected our results of operations, our cash flows and our financial condition: costs incurred related to the pending merger with Inamed; and

adoption of SFAS No. 123R.

**Costs Incurred Related to the Pending Merger with Inamed**

On March 20, 2005, Medicis, Masterpiece Acquisition Corp. (a wholly-owned subsidiary of Medicis), and Inamed entered into an Agreement and Plan of Merger. Inamed is a global healthcare company that develops, manufactures, and markets a diverse line of products that enhance the quality of people's lives. These products include breast implants for aesthetic augmentation and reconstructive surgery following a mastectomy, a range of dermal products to correct facial wrinkles, the BioEnterics® LAP-BAND® System designed to treat severe and morbid obesity, and the BioEnterics® IntraGastric Balloon (BIB®) system for the treatment of obesity. Inamed's common stock trades on the NASDAQ National Market under the symbol IMDC.

Under the terms of the Agreement and Plan of Merger, Inamed will merge with and into Masterpiece Acquisition Corp. and each share of Inamed common stock will be converted into the right to receive 1.4205 shares of Medicis common stock and \$30.00 in cash. The completion of the transaction is subject to several customary conditions, including the receipt of applicable approvals from Medicis' and Inamed's stockholders, the absence of any material adverse effect on either party's business and the receipt of regulatory approvals. The Agreement and Plan of Merger was filed with the Securities and Exchange Commission (SEC) by the Company as part of an 8-K filed on March 21, 2005.

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We have incurred approximately \$11.4 million of professional and other costs related to the transaction, including approximately \$2.8 million of such costs during the three months ended September 30, 2005. The costs are included in other long-term assets in the accompanying condensed consolidated balance sheets. Business integration costs related to the transaction, including the planning for and implementation of integration activities are being expensed as incurred. During the first quarter of fiscal 2006, we incurred approximately \$0.7 million of business integration planning costs, which are included in selling, general and administrative expenses in the accompanying condensed consolidated statements of income. We anticipate that we will continue to incur significant costs related to this transaction prior to and after closing.

The discussions in this report relate to Medicis as a stand-alone entity and do not include or reflect the operating results of Inamed or the impact of the proposed merger with Inamed following the closing of the transaction.

**Adoption of SFAS No. 123R**

During December 2004, the FASB issued SFAS No. 123R, which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Share-based payments include stock option and nonvested share grants. We grant options to purchase common stock to some of our employees and directors under various plans at prices equal to the market value of the stock on the dates the options were granted. We historically have accounted for stock options using the method prescribed in Accounting Principals Board Opinion No. 25,

Accounting for Stock Issued to Employees, ( APB Opinion No. 25 ) whereby stock options are granted at market price and no compensation cost is recognized, and disclosed the pro forma effect on net earnings assuming compensation cost had been recognized in accordance with SFAS No. 123. SFAS No. 123R, which was effective for us beginning in the first quarter of fiscal year 2006, eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, and generally requires that such transactions be accounted for using prescribed fair-value-based methods. SFAS No. 123R permits public companies to adopt its requirements using one of two methods: (a) a modified prospective method in which compensation costs are recognized beginning with the effective date based on the requirements of SFAS No. 123R for all share-based payments granted or modified after the effective date, and based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date or (b) a modified retrospective method which includes the requirements of the modified prospective method described above, but also permits companies to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either for all periods presented or prior interim periods of the year of adoption. We have decided to adopt SFAS No. 123R using the modified prospective method. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under historical literature.

During the three months ended September 30, 2005, we recognized approximately \$7.7 million of compensation expense related to the expensing of stock options and restricted stock in accordance with SFAS No. 123R. Approximately \$7.2 million and \$0.5 million of this amount is included in selling, general and administrative expenses and research and development expenses, respectively, in the accompanying condensed consolidated statements of income.

**Table of Contents****RESULTS OF OPERATIONS**

The following table sets forth certain data as a percentage of net revenues for the periods indicated.

	<b>THREE MONTHS ENDED</b>	
	<b>SEPTEMBER</b>	<b>SEPTEMBER</b>
	<b>30,</b>	<b>30,</b>
	<b>2005</b>	<b>2004</b>
Net revenues	100.0%	100.0%
Gross profit	85.6	84.4
Operating expenses	63.5**	83.0*
Operating income	22.1	1.4
Interest income (expense), net	1.7	(0.1)
Income before income tax expense	23.8	1.3
Income tax expense	(8.8)	(0.1)
Net income	15.0%	1.2%

\* Included in operating expenses is \$30.7 million (34.6% of net revenues) related to our exclusive license agreement with Q-Med for the development of SubQ™ and \$0.1 million (0.1% of net revenues) of compensation expense related to restricted stock.

\*\* Included in operating expenses is \$7.7 million (9.2% of net revenues) of compensation expense related to stock options and restricted stock, and \$0.7 million (0.8% of net revenues) of business integration planning costs related to the proposed merger with Inamed.

**Three Months Ended September 30, 2005 Compared to the Three Months Ended September 30, 2004****Net Revenues**

The following table sets forth the net revenues for the three months ended September 30, 2005 (the first quarter of fiscal 2006 ) and September 30, 2004 (the first quarter of fiscal 2005 ), along with the percentage of net revenues for each of our product categories (dollar amounts in millions):

	First Quarter	First Quarter	\$	%
	Fiscal 2006	Fiscal 2005	Change	Change
Net product revenues	\$ 79.4	\$ 72.1	\$ 7.3	10.1%
Net contract revenues	\$ 3.9	\$ 16.7	\$ (12.8)	(76.9)%
Net revenues	\$ 83.3	\$ 88.8	\$ ( 5.5)	(6.3)%

	First Quarter	First Quarter	Change
	Fiscal 2006	Fiscal 2005	
Acne and acne-related dermatological products	32.6%	31.3%	1.3%
Non-acne dermatological products	56.2%	44.7%	11.5%
Non-dermatological products	11.2%	24.0%	(12.8)%
Total net revenues	100.0%	100.0%	



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Our total net revenues decreased during the first quarter of fiscal 2006 primarily as a result of a decrease in net contract revenues associated with licensing agreements and authorized generic agreements. Net contract revenues decreased primarily due to a decrease in contract revenues during the first quarter of fiscal 2006 related to our outlicensing of the ORAPRED® brand pursuant to the terms of our license agreement with BioMarin. Core brand revenues, which are included in net product revenues and includes revenues associated with RESTYLANE®, DYNACIN®, LOPROX®, OMNICEF®, PLEXION®, TRIAZ® and VANOS, represented approximately \$71.8 million, or approximately 86.2% of net revenues, during the first quarter of fiscal 2006, an increase of approximately 7.2%, compared to core brand revenues of approximately \$67.0 million, or approximately 75.4% of net revenues, for the first quarter of fiscal 2005. Net revenues associated with our acne and acne-related dermatological products increased slightly as a percentage of net revenues during the first quarter of fiscal 2006, and was consistent in net dollars with the net revenues recognized during the first quarter of fiscal 2005. Net revenues associated with our non-acne dermatological products increased as a percentage of net revenues, and increased in net dollars by 18.0% during the first quarter of fiscal 2006, primarily due to an increase in sales of RESTYLANE®. Net revenues associated with our non-dermatological products decreased as a percentage of net revenues primarily due to the decrease in contract revenues discussed above.

**Gross Profit**

Gross profit represents our net revenues less our cost of product revenue. Our cost of product revenue includes our acquisition cost for the products we purchase from our third party manufacturers and royalty payments made to third parties. Amortization of intangible assets related to acquired products is not included in gross profit. Amortization expense related to these intangible assets for the first quarter of fiscal 2006 and 2005 was approximately \$5.6 million and \$4.4 million, respectively. Product sales mix plays a significant role in our quarterly and annual gross profit as a percentage of net revenues. Different products generate different gross profit margins, and the relative sales mix of higher gross profit products and lower gross profit products can affect our total gross profit.

The following table sets forth our gross profit for the first quarter of fiscal 2006 and 2005, along with the percentage of net revenues represented by such gross profit (dollar amounts in millions):

	First Quarter	First Quarter		%
	Fiscal 2006	Fiscal 2005	\$Change	Change
Gross profit	\$ 71.2	\$ 75.0	\$ (3.8)	(5.0)%
% of net revenues	85.6%	84.4%		

The decrease in gross profit during the first quarter of fiscal 2006, compared to the first quarter of fiscal 2005 was due to the decrease in our net revenues. The increase in gross profit as a percentage of net revenues was primarily due to the different sales mix of products sold during the first quarter of fiscal 2006, compared to during the first quarter of fiscal 2005.

**Selling, General and Administrative Expenses**

The following table sets forth our selling, general and administrative expenses for the first quarter of fiscal 2006 and 2005, along with the percentage of net revenues represented by selling, general and administrative expenses (dollar amounts in millions):

	First Quarter	First Quarter	\$	%
	Fiscal 2006	Fiscal 2005	Change	Change
Selling, general and administrative	\$ 41.5	\$ 32.9	\$ 8.6	26.0%
% of net revenues	49.8%	37.1%		
Share-based compensation expense included in selling, general and administrative	\$ 7.2	\$ 0.1	\$ 7.1	5,479.7%



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The increase in selling, general and administrative expenses from the first quarter of fiscal 2005 to the first quarter of fiscal 2006 was attributable to approximately \$7.1 million of additional share-based compensation expense recognized upon our adoption of SFAS No. 123R, approximately \$0.7 million of business integration planning costs related to the proposed merger with Inamed, and \$1.5 million of additional selling, general and administrative expenses incurred during the first quarter of fiscal 2006, partially offset by approximately \$0.7 million of professional fees related to a research and development collaboration with Q-Med for the development of SubQ™ incurred during the first quarter of fiscal 2005.

**Research and Development Expenses**

The following table sets forth our research and development expenses for the first quarter of fiscal 2006 and 2005 (dollars amounts in millions):

	First Quarter Fiscal 2006	First Quarter Fiscal 2005	\$ Change	% Change
Research and development	\$ 5.1	\$ 35.8	\$ (30.7)	(85.9)%
Charges included in research and development		30.0	(30.0)	(100.0)%
Share-based compensation expense included in research and development	\$ 0.5		\$ 0.5	100.0%

The decrease in research and development expenses from the first quarter of fiscal 2005 to the first quarter of fiscal 2006 was attributable to a \$30.0 million research and development payment related to a license agreement with Q-Med for the development of SubQ™ incurred during the first quarter of fiscal 2005, \$0.5 million of compensation expense for stock options and restricted stock recognized upon our adoption of SFAS No. 123R incurred during the first quarter of fiscal 2006, and \$1.2 million related to the timing of various research and development projects. We expect research and development expenses to fluctuate from quarter to quarter based on the timing of the achievement of development milestones under license and development agreements, as well as the timing of other development projects and the funds available to support these projects.

**Depreciation and Amortization Expenses**

Depreciation and amortization expenses during the first quarter of fiscal 2006 increased \$1.3 million, or 25.3%, to \$6.3 million from \$5.0 million during the first quarter of fiscal 2005. This increase was primarily due to increased amortization that began during the third quarter of fiscal 2005 related to certain intangible assets whose useful lives were determined to be shorter than originally estimated.

**Interest Income**

Interest income during the first quarter of fiscal 2006 increased \$1.6 million, or 63.3%, to \$4.1 million from \$2.5 million during the first quarter of fiscal 2005, primarily due to an increase in the interest rates achieved by our invested funds during the first quarter of fiscal 2006.

**Interest Expense**

Interest expense during the first quarter of fiscal 2006 remained consistent with the first quarter of fiscal 2005, at \$2.7 million. Our interest expense during the first quarter of fiscal 2006 and 2005 consisted of interest expense on our Old Notes, which accrue interest at 2.5% per annum, our New Notes, which accrue interest at 1.5% per annum, and amortization of fees and other origination costs related to the issuance of the Old Notes and New Notes. See Note 11 in our accompanying condensed consolidated financial statements for further discussion on the Old Notes and New Notes.

**Table of Contents****Income Tax Expense**

The following table sets forth our income tax expense and the resulting effective tax rate stated as a percentage of pre-tax income for the first quarters of fiscal 2006 and 2005 (dollar amounts in millions):

	First Quarter Fiscal 2006	First Quarter Fiscal 2005	\$ Change	% Change
Income tax expense	\$ 7.4	\$ 0.1	\$ 7.3	7,676.9%
Effective tax rate	37.2%	8.5%		

Income taxes are determined using an annual effective tax rate, which generally differs from the U.S. Federal statutory rate, primarily because of state and local income taxes, tax-exempt interest, charitable contribution deductions and research and development tax credits available in the U.S.. Our effective tax rate may be subject to fluctuations during the fiscal year as new information is obtained which may affect the assumptions we use to estimate our annual effective tax rate, including factors such as our mix of pre-tax earnings in the various tax jurisdictions in which we operate, valuation allowances against deferred tax assets, reserves for tax audit issues and settlements, utilization of research and development tax credits and changes in tax laws in jurisdictions where we conduct operations. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. We record valuation allowances against our deferred tax assets to reduce the net carrying value to an amount that management believes is more likely than not to be realized.

Income tax expense during the first quarter of fiscal 2006 increased 7,676.9%, or \$7.3 million, to \$7.4 million, from income tax expense of \$0.1 million in the first quarter of fiscal 2005. The increase in income tax expense was primarily due to the increase in our pre-tax income for the same period. The provision for income taxes reflects management's estimate of the effective tax rate expected to be applicable for the full fiscal year. Based on information currently available, we believe that our fiscal 2006 rate will be approximately 37%. The estimate of our fiscal 2006 effective tax rate is higher than our fiscal 2005 effective tax rate of 34.4% primarily due to: (i) the statutory expiration of the U.S. research and development tax credit on December 31, 2005, (ii) higher income taxes in foreign jurisdictions in which we operate, (iii) an increase in the relative weighting of taxable interest income in our mix of taxable and tax-exempt interest income and (iv) the adoption of SFAS No. 123R which precludes the recognition of tax benefits relating to the expensing of share based awards that are not ordinarily designed to result in a tax deduction.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES****Overview**

The following table highlights selected cash flow components for the first quarters of fiscal 2006 and 2005, and selected balance sheet components as of September 30, 2005 and June 30, 2005 (dollar amounts in millions):

	First Quarter	First Quarter	\$	%
	Fiscal 2006	Fiscal 2005	Change	Change
Cash provided by (used in):				
Operating activities	\$ 28.1	\$ 13.9	\$ 14.2	101.8%
Investing activities	45.7	96.5	(50.8)	(52.6)%
Financing activities	(1.5)	(59.1)	57.6	97.5%
	Sept. 30, 2005	June 30, 2005	\$	%
			Change	Change
Cash, cash equivalents and short-term investments	\$ 628.4	\$ 603.6	\$ 24.8	4.1%
Working capital	625.4	600.1	25.3	4.2%
2.5% contingent convertible senior notes due 2032	169.2	169.2		
1.5% contingent convertible senior notes due 2033	283.9	283.9		

**Working Capital**

Working capital as of September 30, 2005 and June 30, 2005 consisted of the following (dollar amounts in millions):

	Sept. 30, 2005	June 30, 2005	\$	%
			Change	Change
Cash, cash equivalents and short-term investments	\$ 628.4	\$ 603.6	\$ 24.8	4.1%
Accounts receivable, net	43.3	47.2	(3.9)	(8.2)%
Inventories, net	19.7	20.7	(1.0)	(4.8)%
Deferred tax assets, net	8.5	11.0	(2.5)	(22.9)%
Other current assets	13.1	16.4	(3.3)	(20.3)%
Total current assets	713.0	698.9	14.1	2.0%
Accounts payable	26.6	30.8	(4.2)	(13.6)%
Short-term contract obligation	27.4	27.4		
Income taxes payable	7.5	10.2	(2.7)	(26.9)%
Other current liabilities	26.1	30.4	(4.3)	(14.2)%
Total current liabilities	87.6	98.8	(11.2)	(11.4)%
Working capital	\$ 625.4	\$ 600.1	\$ 25.3	4.2%

The increase in our cash, cash equivalents and short-term investments and working capital were primarily due to \$28.1 million of operating cash flow generated during the first quarter of fiscal 2006.

Our cash and short-term investments are available for strategic investments, mergers and acquisitions, and other potential large-scale needs. Other than the cash necessary to fund the cash portion of the merger consideration for the Inamed transaction, management believes existing cash and short-term investments, together with funds generated from operations, should be sufficient to meet operating requirements for the foreseeable future. However, in order to provide for greater financial flexibility and liquidity, we may raise additional capital from time to time. In addition, in order to fund the cash portion of the merger consideration for the Inamed transaction, we will raise additional capital.

We are currently pursuing additional headquarter office space to accommodate our expected long-term growth.

**Table of Contents****Operating Activities**

Net cash provided by operating activities during the first quarter of fiscal 2006 increased 101.8%, or \$14.2 million, to \$28.1 million from \$13.9 million during the first quarter of fiscal 2005. The increase was primarily attributable to the \$30.0 million research and development payment made in connection with the Q-Med licensing agreement for the development of SubQ™ during the first quarter of fiscal 2005.

**Investing Activities**

Net cash provided by investing activities during the first quarter of fiscal 2006 was \$45.7 million, compared to net cash provided by investing activities during the first quarter of fiscal 2005 of \$96.5 million. The change in net cash provided by investing activities was due to the net purchases or sales of our short-term investments during the respective quarters.

**Financing Activities**

Net cash used in financing activities during the first quarter of fiscal 2006 was \$1.5 million, compared to net cash used in financing activities of \$59.1 million during the first quarter of fiscal 2005. The change was primarily attributable to the purchase of \$65.9 million of treasury stock during the first quarter of fiscal 2005 while no cash was used to purchase treasury stock during the first quarter of fiscal 2006.

**Contingent Convertible Senior Notes and Other Long-Term Commitments**

On August 14, 2003, we exchanged \$230.8 million in principal amount of our Old Notes for \$283.9 million in principal amount of our New Notes. Holders of Old Notes that accepted the Company's exchange offer received \$1,230 in principal amount of New Notes for each \$1,000 in principal amount of Old Notes. The terms of the New Notes are similar to the terms of the Old Notes, but have a different interest rate, conversion rate and maturity date. Holders of Old Notes that did not exchange will continue to be subject to the terms of the Old Notes. See Note 11 of Notes to Condensed Consolidated Financial Statements for further discussion.

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

Except for the Old Notes, the New Notes and deferred tax liabilities, we have no long-term liabilities and had only \$85.2 million of current liabilities at September 30, 2005. Our other commitments and planned expenditures consist principally of payments we will make in connection with strategic collaborations and research and development expenditures, and we will continue to invest in sales and marketing infrastructure.

On March 20, 2005, Medicis entered into a Senior Secured Financing Commitment Letter with Deutsche Bank Trust Company Americas and Deutsche Securities Inc. (the Letter). Subject to the terms and conditions of the Letter, Deutsche Bank Trust Company Americas and Deutsche Securities Inc. have committed to provide \$650.0 million of senior secured financing to Medicis. The Letter provides that the committed financing would mature in seven years and bear interest at an adjustable rate plus London Interbank Offered Rate (LIBOR). The indebtedness would be guaranteed by the Medicis domestic subsidiaries and secured by all assets and stock owned by Medicis and its domestic subsidiaries. The Letter includes customary conditions to funding, including, without limitation, no material adverse change to the market for credit facilities similar in nature to the facility contemplated by the Letter that has had a material adverse effect on syndication, the absence of a material adverse effect on Inamed, certain ratings requirements, the accuracy of representations and warranties of the parties, and the absence of a material adverse effect on Inamed relating to the SEC's investigation of Inamed as disclosed in Inamed's Annual Report on Form 10-K for the year ended December 31, 2004. The Letter was entered into in connection with the acquisition and execution of the Agreement and Plan of Merger.

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We have made available to BioMarin the ability to draw down on a Convertible Note up to \$25.0 million beginning July 1, 2005. The Convertible Note is convertible based on certain terms and conditions including a change of control provision. Money advanced under the Convertible Note is convertible into BioMarin shares at a strike price equal to the BioMarin average closing price for the 20 trading days prior to such advance. The Convertible Note matures on the option purchase date in 2009 as defined in the Securities Purchase Agreement but may be repaid by BioMarin at any time prior to the option purchase date. As of November 8, 2005, BioMarin has not requested any monies to be advanced under the Convertible Note, and no amounts are outstanding.

**Repurchases of Common Stock**

During the three months ended September 30, 2004, we purchased 1,743,800 shares of its Class A common stock in the open market at an average price of \$37.76 per share. These stock purchases were made in accordance with a stock repurchase program that was approved by our Board of Directors in August 2004. This program provided for the repurchase of up to \$150 million of Class A common stock at such times as management determined. As of September 30, 2005, we had repurchased a total of approximately \$150.0 million of Class A common stock pursuant to this program, all during the six months ended December 31, 2004. As the purchase limit had been reached, the plan was terminated. During the three months ended September 30, 2005, we did not purchase any shares of our Class A common stock. The timing and amount of any future repurchases will depend on market conditions and corporate considerations.

**Dividends**

Since the beginning of fiscal 2004, we have paid quarterly cash dividends aggregating \$13.5 million on our common stock. In addition, on September 14, 2005, we declared a cash dividend of \$0.03 per issued and outstanding share of common stock payable on October 31, 2005 to our stockholders of record at the close of business on October 3, 2005. Prior to these dividends, we had not paid a cash dividend on our common stock, and we have not adopted a dividend policy. Any future determinations to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon our financial condition, operating results, capital requirements and other factors that our Board of Directors deems relevant.

**Line of Credit**

We have a revolving line of credit facility of up to \$25.0 million from Wells Fargo Bank, N.A. The facility may be drawn upon by us, at our discretion, and is collateralized by certain short-term investments. Any outstanding balance of the credit facility bears interest at a floating rate of 150 basis points in excess of the 30-day LIBOR and expires in November 2006. The agreement requires us to comply with certain covenants, including covenants relating to our financial condition and results of operation; we are in compliance with all such covenants and have not drawn on this credit facility.

**Off-Balance Sheet Arrangements**

As of September 30, 2005, we are not involved in any off-balance sheet arrangements, as defined in Item 3(a)(4)(ii) of SEC Regulation S-K.

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**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. The preparation of the condensed consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates related to sales allowances, chargebacks, rebates, returns and other pricing adjustments, depreciation and amortization and other contingencies and litigation. We base our estimates on historical experience and various other factors related to each circumstance. 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 we sell our products, changes in the health care environment and managed care consumption patterns. Our significant accounting policies are described in Note 2 to the consolidated financial statements included in our Form 10-K for the fiscal year ended June 30, 2005. We believe the following critical accounting policies affect our most significant estimates and assumptions used in the preparation of our condensed consolidated financial statements and are important in understanding our financial condition and results of operations.

**Revenue Recognition**

Revenue from product sales is recognized primarily when the merchandise is received by an unrelated third party pursuant to Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition in Financial Statements. Accordingly, revenue is recognized when all four of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products has occurred; (iii) the selling price is both fixed and determinable; and (iv) collectibility is reasonably assured. Our customers consist primarily of large pharmaceutical wholesalers who sell directly into the retail channel.

We do not provide any forms of price protection to our wholesale customers and permit product returns if the product is damaged, or if it is returned within six months prior to expiration or up to 12 months after expiration. Our customers consist principally of financially viable wholesalers; so, revenue is recorded upon sale to the wholesaler, net of estimated provisions.

We enter into licensing arrangements with other parties whereby we receive contract revenue based on the terms of the agreement. The timing of revenue recognition is dependent on the level of our continuing involvement in the manufacture and delivery of licensed products. If we have continuing involvement, the revenue is deferred and recognized on a straight-line basis over the period of continuing involvement. In addition, if our licensing arrangements require no continuing involvement and payments are merely based on the passage of time, we will assess such payments for revenue recognition under the collectibility criteria of SAB 104.

*Items Deducted From Gross Revenue*

Provisions for estimates for product returns and exchanges, sales discounts, chargebacks, managed care and Medicaid rebates and other adjustments are established as a reduction of product sales revenues at the time such revenues are recognized. These deductions from gross revenue are established by us as our best estimate at the time of sale based on historical experience adjusted to reflect known changes in the factors that impact such reserves. These deductions from gross revenue are generally reflected either as a direct reduction to accounts receivable through an allowance, or as an addition to accrued expenses if the payment is due to a party other than the wholesale or retail customer.

Our accounting policies for revenue recognition have a significant impact on our reported results and rely on certain estimates that require complex and subjective judgment on the part of our management. If the levels of product returns and exchanges, cash discounts, chargebacks, managed care and Medicaid rebates and other adjustments fluctuate significantly and/or if our estimates do not adequately reserve for these reductions of gross product revenues, our reported net product revenues could be negatively affected.

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*Product Returns and Exchanges*

We account for returns and exchanges of product in accordance with SFAS 48, Revenue Recognition When Right of Return Exists, whereby an allowance is established based on our estimate of revenues recorded for which the related products are expected to be returned in the future. We determine our estimate of product returns and exchanges based on historical experience and other qualitative factors that could impact the level of future product returns and exchanges. These factors include estimated shelf life, competitive developments including introductions of generic products, product discontinuations and our introduction of new formulations of our products. Typically, these other factors that influence our allowance for product returns and exchanges do not change significantly from quarter to quarter. Historical experience and the other qualitative factors are assessed on a product-specific basis as part of our compilation of our estimate of future product returns and exchanges. Estimates for returns and exchanges of new products are based on historical experience of new products at various stages of their life cycle.

Our actual experience and the qualitative factors that we use to determine the necessary allowance for future product returns and exchanges are susceptible to change based on unforeseen events and uncertainties. We review our allowance for product returns and exchanges quarterly to assess the trends being considered to estimate the allowance, and make changes to the allowance if necessary.

*Sales Discounts*

We offer cash discounts to our customers as an incentive for prompt payment, generally approximately 2% of the sales price. We account for cash discounts by establishing an allowance reducing accounts receivable by the full amount of the discounts expected to be taken by the customers.

*Contract Chargebacks*

We have agreements for contract pricing with several entities, whereby pricing on products is extended below wholesaler list price. These parties purchase products through wholesalers at the lower contract price, and the wholesalers charge the difference between their acquisition cost and the lower contract price back to us. We account for chargebacks by establishing an allowance reducing accounts receivable based on our estimate of chargeback claims attributable to a sale. We determine our estimate of chargebacks based on historical experience and changes to current contract prices. We also consider our claim processing lag time and adjust the allowance periodically throughout each quarter to reflect actual experience.

*Total Allowances*

Accounts receivable are presented net of allowances related to the above provisions, which approximated \$14.2 million and \$19.1 million at September 30, 2005 and June 30, 2005, respectively.

*Managed Care and Medicaid Rebates*

We establish and maintain reserves for amounts payable by us to managed care organizations and state Medicaid programs for the reimbursement of portions of the retail price of prescriptions filled that are covered by these programs. The amounts estimated to be paid relating to products sold are recognized as deductions from gross revenue and as additions to accrued expenses at the time of sale based on our best estimate of the expected prescription fill rate to these managed care and state Medicaid patients, using historical experience adjusted to reflect known changes in the factors that impact such reserves, including changes in formulary status and contractual pricing.

Accrued liabilities include reserves of approximately \$6.2 million and \$5.3 million at September 30, 2005 and June 30, 2005, respectively, for estimated managed care and Medicaid rebates.

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In addition to the significant items deducted from gross revenue described above, we deduct other items from gross revenue. For example, we offer consumer rebates on many of our products and a consumer loyalty program for our RESTYLANE® dermal filler product. We generally account for these other items deducted from gross revenue by establishing an accrual based on our estimate of the adjustments attributable to a sale. We generally base our estimates for the accrual of these items deducted from gross sales on historical experience and other relevant factors. We adjust our accruals periodically throughout each quarter based on actual experience and changes in other factors, if any.

We believe that our allowances and accruals for items that are deducted from gross revenue are reasonable and appropriate based on current facts and circumstances. However, it is possible that other parties applying reasonable judgment to the same facts and circumstances could develop different allowance and accrual amounts for items that are deducted from gross revenue. Additionally, changes in actual experience or changes in other qualitative factors could cause our allowances and accruals to fluctuate. A five percent change in the expenses related to the allowances and accruals described above would lead to an approximate \$5.9 million annual effect on our income before income tax expense, based on the amount of expense we recognized during fiscal 2005 related to the allowances and accruals described above.

**Share-Based Compensation**

As part of our adoption of SFAS No. 123R as of July 1, 2005, we were required to recognize the fair value of share-based compensation awards as an expense. We apply the Black-Scholes option-pricing model in order to determine the fair value of stock options on the date of grant, and we apply judgment in estimating key assumptions that are important elements in the model such as the expected stock-price volatility, expected stock option life and expected forfeiture rates. Our estimates of these important assumptions are based on historical data and judgment regarding market trends and factors.

If actual results are not consistent with our assumptions and judgments used in estimating these factors, we may be required to record additional stock-based compensation expense or income tax expense, which could be material to our results of operations.

As of September 30, 2005, total unrecognized compensation cost related to nonvested stock option awards was approximately \$71.5 million and the related weighted-average period over which it is expected to be recognized is approximately 3.1 years. Approximately \$49.7 million of this amount relates to options that would accelerate and be immediately expensed upon closing of the merger transaction between Medicis and Inamed.

**Goodwill and Other Identifiable Intangible Assets**

We have in the past made acquisitions of products and businesses that include goodwill, license agreements, product rights and other identifiable intangible assets. We assess the impairment of goodwill and other identifiable intangibles whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Some factors we consider important which could trigger an impairment review include the following: (i) significant underperformance relative to expected historical or projected future operating results; (ii) significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and (iii) significant negative industry or economic trends.

When we determine that the carrying value of goodwill and other identifiable intangibles may not be recoverable based upon the existence of one or more of the above indicators of impairment, we first will perform an assessment of the asset's recoverability based on expected undiscounted future net cash flow and, if the amount is less than the asset's value, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. We are required to perform an annual impairment review, and more frequently under certain circumstances. Goodwill is subjected to this test during the fourth quarter of our fiscal year. The impairment review process compares the fair value of the reporting unit to its carrying value. If we determine through the impairment process that goodwill has been impaired, we will record the impairment charge in the statement of income. As of September 30, 2005, there was no impairment charge related to goodwill. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

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As a result of our acquisitions, we included approximately \$64.7 million of goodwill on our condensed consolidated balance sheets as of September 30, 2005 and June 30, 2005.

As a result of our acquisitions of product rights and other identifiable intangible assets, we have included approximately \$254.2 million and \$259.5 million as net intangible assets on our consolidated balance sheets as of September 30, 2005 and June 30, 2005, respectively. Estimated amortization expense for other identifiable intangible assets as of June 30, 2005 is approximately \$22.4 million for the fiscal year ended June 30, 2006, approximately \$21.5 million for the fiscal years ended June 30, 2007 and June 30, 2008, approximately \$20.7 million for the fiscal year ended June 30, 2009, and approximately \$16.4 million for the fiscal year ended June 30, 2010.

### **Income Taxes**

Income taxes are determined using an annual effective tax rate, which generally differs from the U.S. Federal statutory rate because of state and local income taxes, tax-exempt interest, charitable contribution deductions, nondeductible expenses and research and experimentation tax credits available in the U.S.. Our effective tax rate may be subject to fluctuations during the fiscal year as new information is obtained which may affect the assumptions we use to estimate our annual effective tax rate, including factors such as our mix of pre-tax earnings in the various tax jurisdictions in which we operate, valuation allowances against deferred tax assets, reserves for tax audit issues and settlements, utilization of research and experimentation tax credits and changes in tax laws in jurisdictions where we conduct operations. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. We record valuation allowances against our deferred tax assets to reduce the net carrying value to an amount that management believes is more likely than not to be realized.

Based on the Company's historical pre-tax earnings, management believes it is more likely than not that the Company will realize the benefit of the existing net deferred tax assets at September 30, 2005. Management believes the existing net deductible temporary differences will reverse during periods in which the Company generates net taxable income; however, there can be no assurance that the Company will generate any earnings or any specific level of continuing earnings in future years. Certain tax planning or other strategies could be implemented, if necessary, to supplement income from operations to fully realize recorded tax benefits.

Deferred income taxes are presented net of a valuation allowance of approximately \$17.5 million as of September 30, 2005 and June 30, 2005. The valuation allowance relates to attributes acquired in the merger with Ascent that will not be realized based on the statutory limitations under the change in control provisions of the Internal Revenue Code.

### **Research and Development Costs and Accounting for Strategic Collaborations**

All research and development costs, including payments related to products under development and research consulting agreements, are expensed as incurred. We may continue to make up-front, non-refundable payments to third parties for new technologies and for research and development work that has been completed. These up-front payments may be expensed at the time of payment depending on the nature of the payment made.

Our policy on accounting for costs of strategic collaborations determines the timing of our recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or capitalized as an asset. We are required to form judgments with respect to the commercial status of such products in determining whether development costs meet the criteria for immediate expense or capitalization. For example, when we acquire certain products for which there is already an ANDA or NDA available, and there is net realizable value based on projected sales for these products, we capitalize the amount paid as an intangible asset. In addition, if we acquire product rights that are in the development phase and as to which we have no assurance that the third party is required to perform additional research efforts, we expense such payments.

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During the first quarter of fiscal year 2005, we incurred and expensed an approximately \$30.7 million up-front development payment related to a research and development collaboration. Of the \$30.7 million expensed during the first quarter of fiscal 2005, approximately \$0.7 million were professional fees incurred related to the completion of the collaboration agreement and were included in selling, general and administrative expenses.

**EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In October 2004, the FASB ratified the consensus reached by the EITF on Issue 04-1, *Accounting for Preexisting Relationships between the Parties to a Business Combination*, EITF No. 04-1 requires that a business combination between two parties that have a preexisting relationship be evaluated to determine if a settlement of a preexisting relationship exists. EITF No. 04-1 also requires that certain reacquired rights (including the rights to the acquirer's trade name under a franchise agreement) be recognized as intangible assets apart from goodwill. However, if a contract giving rise to the reacquired rights includes terms that are favorable or unfavorable when compared to pricing for current market transactions for the same or similar items, EITF No. 04-1 requires that a settlement gain or loss should be measured as the lesser of a) the amount by which the contract is favorable or unfavorable under market terms from the perspective of the acquirer or b) the stated settlement provisions of the contract available to the counterparty to which the contract is unfavorable.

EITF No. 04-1 is effective prospectively for business combinations consummated in reporting periods beginning after October 13, 2004. EITF No. 04-1 will apply to the merger with Inamed. The amount and timing of any such gains or losses we might record is dependent upon what we acquire and when the merger is consummated. We currently expect to record a loss of \$16.5 million related to the settlement of certain litigation with Inamed.

In October 2005, the FASB issued FASB Staff Position ( FSP ) No. 123R-2, *Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123R*, to provide guidance on determining the grant date for an award as defined in SFAS No. 123R. This FSP stipulates that assuming all other criteria in the grant date definition are met, a mutual understanding of the key terms and conditions of an award to an individual employee is presumed to exist upon the award's approval in accordance with the relevant corporate governance requirements, provided that the key terms and conditions of an award (a) cannot be negotiated by the recipient with the employer because the award is a unilateral grant, and (b) are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. We have applied the principles set forth in this FSP upon its adoption of SFAS No. 123R.

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**CAUTION REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q and other documents we file with the SEC include forward-looking statements. These include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales and marketing efforts, expenses, the outcome of contingencies, such as legal proceedings, and financial results. From time to time, we also may make forward-looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls, and conference calls. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are based on certain assumptions made by us based on our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward-looking statements. Such statements are subject to a number of assumptions, risks and uncertainties, many of which are beyond our control. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as anticipate, estimate, expect, project, intend, plan, believe, will, should, outlook, could, target, intend, plan, and other words meaning in connection with any discussion of future operations or financial performance. Among the factors that could cause actual results to differ materially from our forward-looking statements are the following:

- the success of research and development activities and the speed with which regulatory authorizations and product launches may be achieved;

- changes in our product mix;

- changes in prescription levels and the effect of economic changes in hurricane-affected areas;

- manufacturing or supply interruptions;

- competitive developments affecting our current growth products, such as the recent FDA approval of HYLAFORM<sup>®</sup>, HYLAFORM PLUS<sup>®</sup> and CAPTIQUE<sup>®</sup>, competitors to RESTYLANE<sup>®</sup>, a generic form of our DYNACIN<sup>®</sup> Tablets product and generic forms of our LOPROX<sup>®</sup> TS and LOPROX<sup>®</sup> Cream products;

- importation of other dermal filler products;

- changes in the prescribing or procedural practices of dermatologists, podiatrists and/or plastic surgeons;

- the ability to successfully market both new and existing products;

- difficulties or delays in manufacturing;

- the ability to compete against generic and other branded products;

- trends toward managed care and health care cost containment;

- our ability to protect our patents and other intellectual property;

- possible U.S. legislation or regulatory action affecting, among other things, pharmaceutical pricing and reimbursement, including Medicaid and Medicare and involuntary approval of prescription medicines for over-the-counter use;

legal defense costs, insurance expenses, settlement costs and the risk of an adverse decision or settlement related to product liability, patent protection, government investigations, and other legal proceedings;

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changes in U.S. generally accepted accounting principles;

additional costs related to compliance with changing regulation of corporate governance and public financial disclosure;

any changes in business, political and economic conditions due to the threat of future terrorist activity in the U.S. and other parts of the world;

the receipt of required regulatory approvals for our merger with Inamed (including the approval of antitrust authorities necessary to complete the merger);

the ability to realize the anticipated synergies and benefits of the merger with Inamed;

the ability to timely and cost-effectively integrate Inamed's and Medicis' operations;

access to available and feasible financing (including financing for the merger with Inamed) on a timely basis;

the risks and uncertainties normally incident to the pharmaceutical and medical device industries, including product liability claims;

the risks and uncertainties associated with obtaining necessary FDA approvals, including the recent approvable letter received from the FDA by Inamed relating to Inamed's responsive silicone gel filled breast implants;

growth in costs and expenses; and

the impact of acquisitions, divestitures and other significant corporate transactions, including the merger with Inamed.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to review any future disclosures contained in the reports that we file with the SEC. Our Annual Report on Form 10-K for the fiscal year ended June 30, 2005 and our Registration Statement on Form S-4 (Registration No. 333-129372) contain discussions of various risks relating to our business that could cause actual results to differ materially from expected and historical results, which is incorporated herein by reference and which you should review. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list or discussion to be a complete set of all potential risks or uncertainties.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of September 30, 2005, there were no material changes to the information previously reported under Item 7A in our Annual Report on Form 10-K for the fiscal year ended June 30, 2005.

**Item 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)), that are designed to ensure that information required to be disclosed in reports filed by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer, with the participation of other members of management, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2005 and have concluded that, as of such date our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules

and forms.

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Although the management of our Company, including the Chief Executive Officer and the Chief Financial Officer, believes that our disclosure controls and internal controls currently provide reasonable assurance that our desired control objectives have been met, management does not expect that our disclosure controls or internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

During the three months ended September 30, 2005, there was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. Other Information**

**Item 1. Legal Proceedings**

On November 9, 2001, prior to its merger with our company, Ascent received notice that Triumph-Connecticut Limited Partnership and related parties ( Triumph ) had brought a civil action against it in the Business Session of the Superior Court of the Commonwealth of Massachusetts. In the action, the Triumph group claimed that the execution by Ascent of the merger agreement and the consummation of the merger without the consent of the Triumph group or the payment to the Triumph group of a specified amount breached the terms of a January 1997 securities purchase agreement, the terms of warrants issued to the Triumph group, an implied covenant of good faith and fair dealing, and certain deceptive trade laws. The Triumph group sought damages in an amount not less than \$22.1 million, plus treble damages. A hearing on cross-motions for summary judgment was held on October 16, 2003. On April 9, 2004, the court ruled on the cross-motions in Ascent s favor. Triumph s cross-motion for summary judgment was denied and Ascent s cross-motion for summary judgment was granted on all claims. The court entered its order dismissing the lawsuit on April 13, 2004. Triumph filed a notice of appeal on May 6, 2004. Both Triumph and Ascent filed appellate briefs. The Massachusetts Appeals Court held a hearing regarding Triumph s appeal on April 15, 2005. A decision may not be issued for several months. We continue to believe that the claims of the Triumph group are without merit.

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On June 21, 2004, the United States International Trade Commission ( ITC ) instituted an investigation pursuant to Section 337 of the Tariff Act of 1930, as amended, at the request of Inamed. The investigation identified Medicis Aesthetics, Inc., a wholly owned subsidiary of our company, and Q-Med as respondents in the investigation regarding Inamed's allegation of infringement of its U.S. Patent No. 4,803,075, dated February 7, 1989, by the dermal filler, RESTYLANE®. On September 16, 2004, Inamed moved to add our distributor, McKesson Corporation ( McKesson ), as a respondent. The motion was granted by the Administrative Law Judge ( ALJ ) and affirmed by the ITC during November 2004. Inamed also filed a parallel infringement action against us and Q-Med in the U.S. District Court of the Southern District of California regarding the same patent. Inamed amended its complaint to add McKesson as a party to this action as well. This action was stayed pending the outcome of the ITC investigation. Pursuant to the Agreement and Plan of Merger (the Merger Agreement ) and related transactions entered into by Medicis, Inamed and a wholly-owned subsidiary of Medicis on March 20, 2005, Inamed filed a motion to dismiss with prejudice Inamed's patent infringement action. In addition, Inamed consented to the dismissal of the ITC matter, which has been granted and has been made final. As consideration for Inamed's dismissal of the litigation against Medicis, Medicis agreed to pay Inamed \$16.5 million if either the \$70.0 million termination fee or the \$10.0 million expense fee becomes payable by Medicis pursuant to Section 5.10(c) of the Merger Agreement or if the Merger Agreement is terminated because Medicis stockholders do not approve the issuance of shares pursuant to the Merger Agreement. If the transaction is terminated as a result of Inamed's shareholders voting against the adoption of the Merger Agreement, then these fees will not be payable by Medicis.

The government has notified us that we have been named as a defendant in a qui tam (whistleblower) lawsuit filed under the federal False Claims Act. We are cooperating with the government in its investigation, which relates to our marketing and promotion of LOPROX® products to pediatricians prior to our May 2004, disposition of its pediatric sales division.

On October 27, 2005, we filed suit against Upsher-Smith Laboratories, Inc. of Plymouth, Minnesota and against Prasco Laboratories of Cincinnati, Ohio for infringement of Patent No. 6,905,675 entitled Sulfur Containing Dermatological Compositions and Methods for Reducing Malodors in Dermatological Compositions covering our sodium sulfacetamide/sulfur technology. This intellectual property is key in our PLEXION® Cleanser product. The suit was filed in the U.S. District Court for the District of Arizona, and seeks an award of damages, as well as a preliminary and a permanent injunction.

We and certain of our subsidiaries are parties to other actions and proceedings incident to our 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. Although the outcome of these actions is not presently determinable, it is the opinion of our management, based upon the information available at this time, the litigation is either covered by insurance and/or established reserves, or in some cases rights of offset and/or indemnification, and that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on our results of operations or financial condition, although an adverse resolution in any reporting period of one or more of the proceedings could have a material impact on the results of operations for that period.

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**Item 6. EXHIBITS**

Exhibit 10.10	Medicis Pharmaceutical Corporation 2001 Senior Executive Restricted Stock Plan
Exhibit 10.11	Waiver Agreement between Jonah Shacknai and the Company, effective as of July 15, 2005
Exhibit 10.12	Waiver Agreement between Mark A. Prygocki, Sr. and the Company, effective as of July 15, 2005
Exhibit 10.13	Waiver Agreement between Richard J. Havens and the Company, effective as of July 15, 2005
Exhibit 10.14	Waiver Agreement between Mitchell S. Wortzman, Ph.D. and the Company, effective as of July 15, 2005
Exhibit 12	Computation of Ratios of Earnings to Fixed Charges
Exhibit 31.1	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification by the Chief Executive Officer and the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MEDICIS PHARMACEUTICAL CORPORATION**

Date: November 9, 2005

By: /s/ Jonah Shacknai

Jonah Shacknai  
Chairman of the Board and  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 9, 2005

By: /s/ Mark A. Prygocki, Sr.

Mark A. Prygocki, Sr.  
Executive Vice President  
Chief Financial Officer, Corporate  
Secretary and Treasurer  
(Principal Financial and Accounting  
Officer)

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