MEDICIS PHARMACEUTICAL CORP
Form 10-Q/A
November 10, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q/A
(Amendment No. 1)

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from __________ to __________

Commission file number 0-18443

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware	52-1574808
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7720 North Dobson Road
Scottsdale, Arizona 85256-2740
(Address of principal executive offices)
(602) 808-8800
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

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

Class	Shares Outstanding at November 3, 2008
Class A Common Stock $.014 Par Value	56,717,496

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EXPLANATORY NOTE

On September 22, 2008, the Audit Committee of the Board of Directors of Medicis Pharmaceutical Corporation (Medicis , the Company , or as used in the context of we , us or our) concluded that our financial statements for th annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008 would likely need to be restated and should no longer be relied upon.

This Amendment No. 1 (the Form 10-Q/A) to our Quarterly Report on Form 10-Q for the three months ended June 30, 2008 (the 2008 Second Quarter 10-Q) is being filed to restate our condensed consolidated financial statements as of June 30, 2008 and for the three and six months ended June 30, 2008 and 2007. In addition, we are concurrently filing Form 10-K/A to amend and restate our consolidated financial statements for the annual and transition periods in fiscal years 2003 through 2007 and a Form 10-Q/A to amend and restate our condensed consolidated financial statements for the quarterly period ended March 31, 2008.

The restatement primarily relates to an error in our interpretation and application of Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48), as it applies to a component of our sales return reserve calculations. Management commenced a review and analysis of its accounting for sales return reserves after the Public Company Accounting Oversight Board s (the PCAOB) inspection of our independent public accounting firm s, Ernst & Young LLP s, audit of our 2007 financial statements. Based on the PCAOB inspection, Ernst & Young LLP informed management that the method of accounting for returns of short dated and expired goods in the periods covered by the financial statements was not in conformity with generally accepted accounting principles, as the returns for expired product did not qualify for warranty or exchange accounting and, accordingly, under SFAS 48, the Company should have deferred the full sales price of the product for the amount of estimated returns. Management conducted a review of whether the reserve complied with SFAS 48 and whether the amounts involved were material under Staff Accounting Bulletin No. 99, *Materiality* (SAB 99), and Staff Accounting Bulletin No. 108, *Considering Effects of Prior Misstatements When Quantifying Misstatements in Current Year Financial Statements* (SAB 108), for one or more periods. Management determined that there was an error in its interpretation and application of SFAS 48 and that the adjustments necessary to properly state the sales returns reserve were material for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008. Accordingly, management recommended to the Audit Committee that a restatement was required.

Our prior accounting method with respect to sales return reserves accrued estimated future returns of short-dated and expired products, which were expected to be replaced with similar products, at replacement cost, based on our view of the economic impact of returns on our business, rather than deferring the gross sales price. The replacement of short-dated and expired products, which was treated as a warranty or an exchange, was reserved for based on the estimated cost associated with the exchange. In the course of our review and analysis, we determined that, although the exchanged product was similar, it was not of the same quality, strictly due to dating, as we were replacing nearly-expired or expired product with newer, fresher product. Therefore, in accordance with SFAS 48, we have revised our reserve calculations to defer the gross sales value of the estimated product returns that were expected to be replaced with similar products. The revised reserve calculations were developed based on conditions that existed at the end of each reporting period and in certain cases were revised based on the Company return experince. Additionally, because of the impact of the changes in the sales returns reserve, we recorded adjustments to certain managed care, Medicaid and consumer rebate accruals and have also reflected the related income tax effects of these adjustments. In addition, related to the modification of the reserve calculation methodology, the reserve for estimated future returns has been classified within current liabilities rather than as an allowance reducing accounts receivable.

The restated condensed consolidated financial statements include other adjustments, including adjustments related to conforming our historical accounting policies to current accounting policies, that were previously identified, but not previously recorded, as they were not material, either individually or in the aggregate. While none of these other adjustments is individually material, they are being made as part of the restatement process.

In connection with the restatement, management has assessed the effectiveness of our disclosure controls and procedures and has included revised disclosure in this Form 10-Q/A under Item 4 of Part I, Controls and Procedures. Management identified a material weakness in our internal control over financial reporting with respect to our interpretation and application of SFAS 48 as it applies to the calculation of sales return reserves, as described in our Form 10-K/A for the year ended December 31, 2007, under Item 9 of Part II in Management s Report on Internal Control over Financial Reporting.. Solely as a result of this material weakness, our Chief

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Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective at a reasonable assurance level as of December 31, 2007 and the date of this report. As of the date of this Form 10-Q/A, management has adopted a sales return reserve methodology that management believes complies with the requirements of SFAS 48. Management has taken and is taking steps, as described in our Form 10-K/A for the year ended December 31, 2007 under Item 9A of Part II in Remediation Steps to Address Material Weakness, to remediate the material weakness in our internal control over financial reporting. We believe that, as a result of management s in-depth review of its accounting processes, the utilization of external resources and the additional procedures management has implemented, there are no material inaccuracies or omissions of material fact in this Form 10-Q/A and, to the best of our knowledge, we believe that the consolidated financial statements in this Form 10-Q/A fairly present in all material aspects the financial condition, results of operations and cash flows of the Company in conformity with generally accepted accounting principles.

Consistent with good corporate governance, the Audit Committee of our Board of Directors, working with its independent counsel and forensic accountants, conducted an independent inquiry into the matters giving rise to the Company s need to restate its financial statements (the Internal Inquiry). After completing the Internal Inquiry, the Audit Committee concluded that the need to restate our consolidated financial statements was not the result of any fraud or intentional wrongdoing on the part of any of our directors, officers or other employees. The Audit Committee also noted that our independent registered public accounting firm, Ernst & Young LLP, was aware of and discussed with us on several occasions in the past our methodology of accounting for sales return reserves. Neither the Company nor Ernst & Young LLP has previously identified the misinterpretation and misapplication of generally accepted accounting principles with respect to our sales return reserves prior to the PCAOB review, and Ernst & Young LLP expressed unqualified opinions on our consolidated financial statements and our internal control over financial reporting for each of the now-restated annual and transition periods. We have discussed this matter with the SEC s Division of Enforcement and have committed to cooperating fully with the SEC in connection with any questions they may have.

Because this Form 10-Q/A sets forth the 2008 Second Quarter Form 10-Q in its entirety, it includes items that have been changed as a result of the restatement and the items that are unchanged from the 2008 Second Quarter Form 10-Q. Other than the amending of the disclosures relating to the restatement, this Form 10-Q/A speaks as of the original filing date of the 2008 Second Quarter 10-Q and has not been updated to reflect other events occurring subsequent to the original filing date. This includes forward-looking statements, Risk Factors, and all other sections of this Form 10-Q/A that were not directly impacted by the restatement, which should be read in their historical context. This Form 10-Q/A should be read in conjunction with our Form 10-K/A for the year ended December 31, 2008, our Form 10-Q/A for the quarter ended March 31, 2008, and our Form 10-Q for the quarter ended September 30, 2008.

Note 2 to our restated condensed consolidated financial statements discloses the nature of the restatement adjustments and details the impact of the restatement adjustments on our condensed consolidated financial statements as of June 30, 2008 and the three and six months ended June 30, 2008 and 2007.

Item 6 of Part II of this Form 10-Q/A has been amended to contain the currently-dated certifications from our principal executive officer and principal financial officer, as required by Section 302 and 906 of the Sarbanes-Oxley Act of 2002.

MEDICIS PHARMACEUTICAL CORPORATION
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Part I. Financial Information
Item 1. Financial Statements

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

	June 30, 2008 (Restated) (unaudited)	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 215,603	$ 108,046
Short-term investments	254,852	686,634
Accounts receivable, net	31,824	22,205
Inventories, net	23,859	29,973
Deferred tax assets, net	39,302	9,190
Other current assets	17,586	18,049
Total current assets	583,026	874,097
Property and equipment, net	24,981	13,850
Intangible assets:		
Intangible assets related to product line acquisitions and business combinations	258,873	258,873
Other intangible assets	7,100	6,695
	265,973	265,568
Less: accumulated amortization	103,170	92,482
Net intangible assets	162,803	173,086
Goodwill	63,107	63,107
Deferred tax assets, net	63,820	59,577
Long-term investments	98,200	17,072
Other assets	12,706	12,622
	$ 1,008,643	$ 1,213,411

See accompanying notes to condensed consolidated financial statements.

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

	June 30, 2008 (Restated) (unaudited)	December 31, 2007
Liabilities		
Current liabilities:		
Accounts payable	$ 43,299	$ 34,891
Current portion of contingent convertible senior notes	181	283,910
Reserve for sales returns	65,543	68,787
Income taxes payable	34,752	7,731
Other current liabilities	59,296	55,807
Total current liabilities	203,071	451,126
Long-term liabilities:		
Contingent convertible senior notes	169,145	169,145
Deferred revenue	5,417	6,667
Other liabilities	8,718	3,172
Stockholders Equity		
Preferred stock, $0.01 par value; shares authorized: 5,000,000; no shares issued		
Class A common stock, $0.014 par value; shares authorized: 150,000,000; issued and outstanding: 69,277,786 and 69,005,019 at June 30, 2008 and December 31, 2007, respectively	968	965
Class B common stock, $0.014 par value; shares authorized: 1,000,000; no shares issued		
Additional paid-in capital	653,471	641,907
Accumulated other comprehensive income	867	2,221
Accumulated earnings	310,160	281,218
Less: Treasury stock, 12,668,410 and 12,656,503 shares at cost at June 30, 2008 and December 31, 2007, respectively	(343,174)	(343,010)
Total stockholders equity	622,292	583,301
	$ 1,008,643	$ 1,213,411

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008 (Restated)	2007 (Restated)	2008 (Restated)	2007 (Restated)
Net product revenues	$ 133,039	$ 110,644	$ 258,092	$ 206,566
Net contract revenues	4,410	2,962	8,260	5,705
Net revenues	137,449	113,606	266,352	212,271
Cost of product revenues (1)	9,204	15,266	20,337	26,828
Gross profit	128,245	98,340	246,015	185,443
Operating expenses:				
Selling, general and administrative (2)	71,872	58,639	143,934	119,835
Impairment of long-lived assets		4,067		4,067
Research and development (3)	33,000	7,148	42,189	15,154
Depreciation and amortization	6,780	5,878	13,502	11,332
Operating income	16,593	22,608	46,390	35,055
Other expense			(2,871)	
Interest and investment income	7,449	9,251	16,649	18,258
Interest expense	(2,148)	(2,568)	(4,555)	(5,226)
Income before income tax expense	21,894	29,291	55,613	48,087
Income tax expense	8,886	10,751	22,080	17,866
Net income	$ 13,008	$ 18,540	$ 33,533	$ 30,221
Basic net income per share	$ 0.23	$ 0.33	$ 0.59	$ 0.54
Diluted net income per share	$ 0.21	$ 0.28	$ 0.52	$ 0.47
Cash dividend declared per common share	$ 0.04	$ 0.03	$ 0.08	$ 0.06

Basic common shares outstanding	56,493	55,936	56,425	55,782
Diluted common shares outstanding	68,443	71,318	69,343	71,466
(1) amounts exclude amortization of intangible assets related to acquired products	$ 5,346	$ 5,165	$ 10,633	$ 9,963
(2) amounts include share-based compensation expense	$ 4,601	$ 5,524	$ 8,930	$ 10,900
(3) amounts include share-based compensation expense	$ 51	$ 117	$ 112	$ 255

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended June 30, 2008 (Restated)	June 30, 2007 (Restated)
Operating Activities:		
Net income (restated)	$ 33,533	$ 30,221
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,502	11,332
Amortization of deferred financing fees	666	982
Impairment of long-lived assets		4,067
Loss on disposal of property and equipment	36	19
Charge reducing value of investment in Revance	2,871	
Gain on sale of available-for-sale investments	(947)	(48)
Share-based compensation expense	9,042	11,156
Deferred income tax (benefit) expense	(34,355)	9,911
Tax (expense) benefit from exercise of stock options and vesting of restricted stock awards	(1,007)	2,387
Excess tax benefits from share-based payment arrangements	(167)	(1,215)
Increase (decrease) in provision for sales discounts and chargebacks	908	(1,331)
Amortization of (discount)/premium on investments	(919)	(1,457)
Changes in operating assets and liabilities:		
Accounts receivable	(10,503)	54,227
Inventories	6,113	(3,641)
Other current assets	463	(3,176)
Accounts payable	5,093	(6,999)
Reserve for sales returns	(3,244)	(16,148)
Income taxes payable	27,023	(11,760)
Other current liabilities	2,159	10
Other liabilities	(1,891)	543
Net cash provided by operating activities	48,376	79,080
Investing Activities:		
Purchase of property and equipment	(7,252)	(4,330)
Payment of direct merger costs	(306)	
Payments for purchase of product rights	(405)	(29,700)
Purchase of available-for-sale investments	(280,874)	(446,542)
Sale of available-for-sale investments	364,739	114,889
Maturity of available-for-sale investments	267,363	131,283
Net cash provided by (used in) investing activities	343,265	(234,400)
Financing Activities:		
Payment of dividends	(3,992)	(3,363)

Payment of contingent convertible senior notes	(283,729)	
Excess tax benefits from share-based payment arrangements	167	1,215
Proceeds from the exercise of stock options	3,532	15,754
Net cash (used in) provided by financing activities	(284,022)	13,606
Effect of exchange rate on cash and cash equivalents	(62)	410
Net increase (decrease) in cash and cash equivalents	107,557	(141,304)
Cash and cash equivalents at beginning of period	108,046	203,319
Cash and cash equivalents at end of period	$ 215,603	$ 62,015

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(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.

The Company offers a broad range of products addressing various conditions or aesthetic improvements including facial wrinkles, acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 18 branded products. Its primary brands are PERLANE®, RESTYLANE®, SOLODYN®, TRIAZ®, VANOS® and ZIANA®.

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

The accompanying interim condensed consolidated financial statements of Medicis have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in the Company s amended Annual Report on Form 10-K/A for the year ended December 31, 2007. The financial information is unaudited, but reflects all adjustments, consisting only of normal recurring adjustments and accruals, which are, in the opinion of the Company s management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q/A should be read in conjunction with the Company s amended Annual Report on Form 10-K/A for the year ended December 31, 2007.

2. RESTATEMENT OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company has restated its condensed consolidated financial statements as of June 30, 2008 and for the three and six months ended June 30, 2008 and 2007. The restatement primarily relates to an error in the Company s interpretation and application of Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48) as its applies to a component of the Company s sales return reserve calculations. Management commenced a review and analysis of its accounting for sales return reserves after the Public Company Accounting Oversight Board s (the PCAOB) inspection of the Company s independent public accounting firm s, Ernst & Young LLP s, audit of the Company s 2007 financial statements. Based on the PCAOB inspection, Ernst & Young LLP informed management that the method of accounting for returns of short-dated and expired goods in the periods covered by the financial statements was not in conformity with generally accepted accounting principles, as the returns for expired product did not qualify for warranty or exchange accounting and, accordingly, under SFAS 48, the Company should have deferred the full sales price of the product for the amount of estimated returns. Management conducted a review of whether the reserve complied with SFAS 48 and whether the amounts involved were material under Staff Accounting Bulletin No. 99, *Materiality* (SAB 99), and Staff Accounting Bulletin No. 108, *Considering Effects of Prior Misstatements When Quantifying Misstatements in Current Year Financial Statements* (SAB 108), for one or more periods. Management determined that there was an error in its interpretation and application of SFAS 48 and that the adjustments necessary to properly state the sales returns reserve were material for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008. Accordingly, management recommended to the Audit Committee that a restatement was required.

The Company s prior accounting method with respect to sales return reserves accrued estimated future returns of short-dated and expired product, which were expected to be replaced with similar products, at replacement cost, based on the Company s view of the economic impact of returns on its business, rather than deferring the gross sales price. The replacement of short-dated and expired product, which was treated as a warranty or an exchange, was reserved for based on the estimated cost associated with the exchange. In the course of the Company s review and analysis, the Company determined that although the exchanged product was similar, it was not of the same quality, strictly due to dating, as the Company was replacing nearly-expired or expired product with newer, fresher product. Therefore, in accordance with SFAS 48, the Company has revised its reserve calculations to defer the gross sales value of the estimated product returns that were expected to be replaced with similar products. The revised reserve calculations were developed based on conditions that existed at the end of each reporting period and in certain cases were revised based on the Company s actual return experience. Additionally, because of the impact of the changes in the sales returns reserve, the Company recorded adjustments to certain managed care, Medicaid and consumer rebate accruals and have also reflected the related income tax effects of these adjustments. The Company s reserve for estimated future returns was previously included as an allowance reducing accounts receivable in the Company s condensed consolidated balance sheets. As a result of the restatement, the reserve for estimated future returns is being classified within current liabilities, rather than as an allowance reducing accounts receivable, in the accompanying condensed consolidated balance sheets.

The restated condensed consolidated financial statements include other adjustments, including adjustments related to conforming the Company s historical accounting policies to current accounting policies, that were previously identified, but not previously recorded, as they were not material, either individually or in the aggregate. While none of these other adjustments is individually material, they are being made as part of the restatement process. These other adjustments include the reclassification of certain amounts in prior year financial statements to conform to the 2007 financial statement presentation, including the reclassification of donated product to charitable organizations from selling, general and administrative expenses to cost of product revenues.

The following is a summary of the effects of the restatement on the Company s condensed consolidated balance sheet as of June 30, 2008, its condensed consolidated statements of operations for the three and six months ended June 30, 2008 and 2007 and its condensed consolidated statements of cash flows for the six months ended June 30, 2008 and 2007:

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CONDENSED CONSOLIDATED BALANCE SHEET
As of June 30, 2008
(in thousands, except share data)

	As Previously Reported	Restatement Adjustments	As Restated
Assets			
Current assets:			
Cash and cash equivalents	$ 215,603		$ 215,603
Short-term investments	254,852		254,852
Accounts receivable, net	23,422	8,402	31,824
Inventories, net	23,859		23,859
Deferred tax assets, net	18,731	20,571	39,302
Other current assets	17,586		17,586
Total current assets	554,053	28,973	583,026
Property and equipment, net	24,981		24,981
Intangible assets:			
Intangible assets related to product line acquisitions and business combinations	258,873		258,873
Other intangible assets	7,468	(368)	7,100
	266,341	(368)	265,973
Less: accumulated amortization	103,170		103,170
Net intangible assets	163,171	(368)	162,803
Goodwill	63,107		63,107
Deferred tax assets, net	63,688	132	63,820
Long-term investments	98,200		98,200
Other assets	12,706		12,706
	$ 979,906	$ 28,737	$ 1,008,643
Liabilities			
Current liabilities:			
Accounts payable	$ 43,299		$ 43,299
Current portion of contingent convertible senior notes	181		181
Reserve for sales returns		65,543	65,543
Income taxes payable	34,138	614	34,752
Other current liabilities	60,853	(1,557)	59,296
	138,471	64,600	203,071
Long-term liabilities:			
Contingent convertible senior notes	169,145		169,145
Deferred revenue	5,417		