

MEDICIS PHARMACEUTICAL CORP

Form 10-Q

May 10, 2011

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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 March 31, 2011

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: 001-14471
MEDICIS PHARMACEUTICAL CORPORATION**

(Exact name of Registrant as specified in its charter)

Delaware

52-1574808

(State or other jurisdiction of
incorporation or organization)

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

7720 North Dobson Road
Scottsdale, Arizona 85256-2740

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

(Registrant's telephone number,
including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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.

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Class
Class A Common Stock \$.014 Par Value

Outstanding at May 4, 2011
61,737,003 (a)

(a) includes 2,068,217 shares of unvested restricted stock awards

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MEDICIS PHARMACEUTICAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

| | March 31, 2011 (unaudited) | December 31, 2010 |
|---|----------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 306,809 | \$ 218,362 |
| Short-term investments | 468,725 | 485,192 |
| Accounts receivable, net | 99,584 | 130,622 |
| Inventories, net | 34,404 | 35,282 |
| Deferred tax assets, net | 79,351 | 70,461 |
| Other current assets | 18,150 | 15,268 |
| Assets held for sale from discontinued operations | 10,054 | 13,127 |
| Total current assets | 1,017,077 | 968,314 |
| Property and equipment, net | 24,077 | 24,435 |
| Net intangible assets | 202,493 | 195,308 |
| Goodwill | 92,398 | 92,398 |
| Deferred tax assets, net | 33,103 | 36,898 |
| Long-term investments | 32,193 | 21,480 |
| Other assets | 2,991 | 2,991 |
| | \$ 1,404,332 | \$ 1,341,824 |

See accompanying notes to condensed consolidated financial statements.

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

| | March 31, 2011 (unaudited) | December 31, 2010 |
|--|----------------------------------|----------------------|
| Liabilities | | |
| Current liabilities: | | |
| Accounts payable | \$ 45,345 | \$ 41,015 |
| Reserve for sales returns | 73,802 | 60,692 |
| Accrued consumer rebates and loyalty programs | 121,704 | 101,678 |
| Managed care and Medicaid reserves | 49,156 | 49,375 |
| Income taxes payable | 15,088 | 4,628 |
| Other current liabilities | 67,507 | 75,228 |
| Liabilities held for sale from discontinued operations | 5,936 | 7,276 |
| Total current liabilities | 378,538 | 339,892 |
| Long-term liabilities: | | |
| Contingent convertible senior notes | 169,326 | 169,326 |
| Other liabilities | 4,960 | 5,084 |
| Stockholders Equity | | |
| Preferred stock, \$0.01 par value; shares authorized: 5,000,000; issued and outstanding: none | | |
| Class A common stock, \$0.014 par value; shares authorized: 150,000,000; issued and outstanding: 72,596,475 and 71,863,191 at March 31, 2011 and December 31, 2010, respectively | 1,000 | 995 |
| Class B common stock, \$0.014 par value; shares authorized: 1,000,000; issued and outstanding: none | | |
| Additional paid-in capital | 728,806 | 715,651 |
| Accumulated other comprehensive loss | (1,949) | (2,149) |
| Accumulated earnings | 475,164 | 460,716 |
| Less: Treasury stock, 13,031,686 and 12,897,610 shares at cost at March 31, 2011 and December 31, 2010, respectively | (351,513) | (347,691) |
| Total stockholders equity | 851,508 | 827,522 |
| | \$ 1,404,332 | \$ 1,341,824 |

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended | |
|--|--------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Net product revenues | \$163,896 | \$163,592 |
| Net contract revenues | 1,017 | 1,950 |
| Net revenues | 164,913 | 165,542 |
| Cost of product revenues (1) | 14,331 | 15,106 |
| Gross profit | 150,582 | 150,436 |
| Operating expenses: | | |
| Selling, general and administrative (2) | 84,630 | 72,284 |
| Research and development (3) | 14,273 | 6,558 |
| Depreciation and amortization | 7,324 | 6,733 |
| Operating income | 44,355 | 64,861 |
| Interest and investment income | (1,274) | (1,160) |
| Interest expense | 1,058 | 1,058 |
| Other expense, net | | 258 |
| Income from continuing operations before income tax expense | 44,571 | 64,705 |
| Income tax expense | 17,886 | 24,683 |
| Net income from continuing operations | 26,685 | 40,022 |
| Loss from discontinued operations, net of income tax benefit | 7,325 | 4,650 |
| Net income | \$ 19,360 | \$ 35,372 |
| Basic net income per share continuing operations | \$ 0.44 | \$ 0.67 |
| Basic net loss per share discontinued operations | \$ (0.12) | \$ (0.08) |

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| | | |
|--|-----------|-----------|
| Basic net income per share | \$ 0.32 | \$ 0.59 |
| Diluted net income per share continuing operations | \$ 0.41 | \$ 0.61 |
| Diluted net loss per share discontinued operations | \$ (0.12) | \$ (0.08) |
| Diluted net income per share | \$ 0.30 | \$ 0.54 |
| Cash dividend declared per common share | \$ 0.08 | \$ 0.06 |
| Common shares used in calculating: | | |
| Basic net income per share | 59,124 | 58,049 |
| Diluted net income per share | 65,381 | 64,192 |

| | | |
|--|---------|---------|
| (1) amounts exclude amortization of intangible assets related to acquired products | \$5,452 | \$5,184 |
| (2) amounts include share-based compensation expense | \$6,284 | \$2,887 |
| (3) amounts include share-based compensation expense | \$ 405 | \$ 55 |

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 | |
|---|--------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Operating Activities: | | |
| Net income | \$ 19,360 | \$ 35,372 |
| Loss from discontinued operations, net of income tax benefit | 7,325 | 4,650 |
| Net income from continuing operations | 26,685 | 40,022 |
| Adjustments to reconcile net income from continuing operations to net cash provided by operating activities from continuing operations: | | |
| Depreciation and amortization | 7,324 | 6,733 |
| Adjustment of impairment of available-for-sale investments | | 260 |
| Loss on sale of available-for-sale investments, net | 7 | 34 |
| Share-based compensation expense | 6,689 | 2,942 |
| Deferred income tax (benefit) expense | (5,124) | 4,336 |
| Tax benefit from exercise of stock options and vesting of restricted stock awards | 658 | 47 |
| Excess tax benefits from share-based payment arrangements | (618) | (287) |
| (Decrease) increase in provision for sales discounts and chargebacks | (509) | 666 |
| Accretion of premium on investments | 1,121 | 826 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 31,547 | (15,454) |
| Inventories | 878 | (3,228) |
| Other current assets | (2,882) | (3,251) |
| Accounts payable | 4,330 | 4,164 |
| Reserve for sales returns | 13,110 | (4,346) |
| Income taxes payable | 10,460 | (856) |
| Other current liabilities | 3,138 | 10,537 |
| Other liabilities | (124) | (998) |
| Net cash provided by operating activities from continuing operations | 96,690 | 42,147 |
| Net cash used in operating activities from discontinued operations | (5,458) | (3,930) |
| Net cash provided by operating activities | 91,232 | 38,217 |
| Investing Activities: | | |
| Purchase of property and equipment | (1,449) | (1,832) |
| Payments for purchase of product rights | (12,702) | 273 |
| Purchase of available-for-sale investments | (109,176) | (207,326) |
| Sale of available-for-sale investments | 11,794 | 12,782 |
| Maturity of available-for-sale investments | 102,090 | 54,215 |

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| | | |
|--|------------|------------|
| Net cash used in investing activities from continuing operations | (9,443) | (141,888) |
| Net cash used in investing activities from discontinued operations | | (126) |
| Net cash used in investing activities | (9,443) | (142,014) |
| Financing Activities: | | |
| Payment of dividends | (3,622) | (2,389) |
| Excess tax benefits from share-based payment arrangements | 618 | 287 |
| Proceeds from the exercise of stock options | 9,515 | 850 |
| Net cash provided by (used in) financing activities | 6,511 | (1,252) |
| Effect of exchange rate on cash and cash equivalents | 147 | 161 |
| Net increase (decrease) in cash and cash equivalents | 88,447 | (104,888) |
| Cash and cash equivalents at beginning of period | 218,362 | 207,941 |
| Cash and cash equivalents at end of period | \$ 306,809 | \$ 103,053 |

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011
(unaudited)

1. NATURE OF BUSINESS

Medicis Pharmaceutical Corporation (Medicis or the Company) is a leading specialty pharmaceutical company focusing primarily on the development and marketing of products in the United States (U.S.) for the treatment of dermatological and aesthetic conditions. Medicis also markets products in Canada for the treatment of dermatological and aesthetic conditions and began commercial efforts in Europe with the Company s acquisition of LipoSonix, Inc. (LipoSonix) in July 2008.

The Company offers a broad range of products addressing various conditions or aesthetic improvements including facial wrinkles, glabellar lines, acne, fungal infections, hyperpigmentation, photoaging, psoriasis, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 14 branded products. Its primary brands are DYSPORT®, PERLANE®, RESTYLANE®, SOLODYN®, VANOS® and ZIANA®. Medicis entered the non-invasive body contouring market with its acquisition of LipoSonix in July 2008. Beginning in the first quarter of 2011, the Company classifies the LipoSonix business as a discontinued operation for financial statement reporting purposes. See Note 2.

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

The accompanying interim condensed consolidated financial statements of Medicis have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The financial information is unaudited, but reflects all adjustments, consisting only of normal recurring adjustments and accruals, which are, in the opinion of the Company s management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

2. DISCONTINUED OPERATIONS

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

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

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The following is a summary of loss from discontinued operations, net of income tax benefit, for the three months ended March 31, 2011 and 2010 (in thousands):

| | Three Months Ended | |
|--|--------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Net revenues | \$ 156 | \$ 949 |
| Cost of revenues | 2,375 | 650 |
| Gross profit | (2,219) | 299 |
| Operating expenses: | | |
| Selling, general and administrative | 5,863 | 3,759 |
| Research and development | 3,346 | 3,511 |
| Depreciation and amortization | | 320 |
| Loss from discontinued operations before income tax benefit | (11,428) | (7,291) |
| Income tax benefit | (4,103) | (2,641) |
| Loss from discontinued operations, net of income tax benefit | \$ (7,325) | \$(4,650) |

The Company includes only revenues and costs directly attributable to the discontinued operations, and not those attributable to the ongoing entity. Accordingly, no interest expense or general corporate overhead costs have been allocated to the LipoSonix discontinued operations. Included in cost of revenues for the three months ended March 31, 2011 was a \$1.9 million charge related to an increase in the valuation reserve for LipoSonix inventory that is not expected to be sold.

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

| | March 31, 2011 | December 31, 2010 |
|---|----------------------|----------------------|
| Cash and cash equivalents | \$ 508 | \$ 629 |
| Accounts receivable, net | 37 | 129 |
| Inventories, net | 3,753 | 4,495 |
| Deferred tax assets, net | 5,500 | 7,328 |
| Other assets | 256 | 546 |
| Assets held for sale from discontinued operations | \$ 10,054 | \$ 13,127 |

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| | | | |
|--|----------|----|-------|
| Accounts payable | \$ 1,951 | \$ | 1,802 |
| Other liabilities | 3,985 | | 5,474 |
| Liabilities held for sale from discontinued operations | \$ 5,936 | \$ | 7,276 |

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The following is a summary of net cash used in operating activities from discontinued operations for the three months ended March 31, 2011 and 2010 (in thousands):

| | Three Months Ended | |
|--|----------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Loss from discontinued operations, net of income tax benefit | \$ (7,325) | \$ (4,650) |
| Depreciation and amortization | | 320 |
| Share-based compensation expense | 728 | 153 |
| Decrease in assets held for sale from discontinued operations | 3,073 | 1,880 |
| Decrease in liabilities held for sale from discontinued operations | (1,934) | (1,633) |
| Net cash used in operating activities from discontinued operations | \$ (5,458) | \$ (3,930) |

Net cash used in investing activities from discontinued operations of \$0.1 million for the three months ended March 31, 2010 represents purchases of property and equipment.

3. SHARE-BASED COMPENSATION

At March 31, 2011, the Company had seven active share-based employee compensation plans. Of these seven share-based compensation plans, only the 2006 Incentive Award Plan is eligible for the granting of future awards.

Stock Option Awards

Stock option awards are granted at the fair market value on the date of grant. The option awards vest over a period determined at the time the options are granted, ranging from one to five years, and generally have a maximum term of ten years. Certain options provide for accelerated vesting if there is a change in control (as defined in the plans). When options are exercised, new shares of the Company's Class A common stock are issued.

The total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of March 31, 2011, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to March 31, 2011, was approximately \$1.1 million and the related weighted average period over which it is expected to be recognized is approximately 3.4 years. All of the unrecognized compensation cost related to stock option awards relates to continuing operations.

A summary of stock option activity within the Company's stock-based compensation plans and changes for the three months ended March 31, 2011, is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|------------------------------|---------------------|--|---|---------------------------------|
| Balance at December 31, 2010 | 6,491,353 | \$30.01 | | |
| Granted | 32,039 | \$31.33 | | |
| Exercised | (355,805) | \$26.74 | | |
| Terminated/expired | (26,505) | \$33.50 | | |
| Balance at March 31, 2011 | 6,141,082 | \$30.19 | 2.5 | \$22,587,779 |

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The intrinsic value of options exercised during the three months ended March 31, 2011 was \$1,578,802. Options exercisable under the Company's share-based compensation plans at March 31, 2011 were 5,930,164, with a weighted average exercise price of \$30.46, a weighted average remaining contractual term of 2.4 years, and an aggregate intrinsic value of \$20,590,567.

A summary of outstanding and exercisable stock options that are fully vested and are expected to vest, based on historical forfeiture rates, as of March 31, 2011, is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|--|-----------------------------|--|--|--|
| Outstanding, net of expected forfeitures | 5,740,277 | \$30.32 | 2.5 | \$20,449,450 |
| Exercisable, net of expected forfeitures | 5,569,337 | \$30.54 | 2.4 | \$18,922,708 |

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:

| | Three Months Ended March 31, 2011 | March 31, 2010 |
|---------------------------------|--|---------------------------|
| Expected dividend yield | 0.77% | 1.06% |
| Expected stock price volatility | 0.33 | 0.33 |
| Risk-free interest rate | 2.81% | 3.04% |
| Expected life of options | 7.0 Years | 7.0 Years |

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

The weighted average fair value of stock options granted during the three months ended March 31, 2011 and 2010, was \$11.45 and \$8.10, respectively.

Restricted Stock Awards

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company's Class A common stock on the date of grant, and the total value of the award is expensed ratably over the service period of the employees receiving the grants. As of March 31, 2011, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to March 31, 2011, was approximately \$43.9 million, and the related weighted average period over which it is expected to be recognized is approximately 3.6 years. Included in the \$43.9 million of total unrecognized compensation cost related to nonvested restricted stock awards is \$2.4 million related to discontinued operations.

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A summary of restricted stock activity within the Company's share-based compensation plans and changes for the three months ended March 31, 2011, is as follows:

| Nonvested Shares | Shares | Weighted Average Grant-Date Fair Value |
|--------------------------------|---------------|---|
| Nonvested at December 31, 2010 | 1,794,445 | \$ 17.94 |
| Granted | 736,048 | \$ 31.33 |
| Vested | (377,479) | \$ 18.93 |
| Forfeited | (12,463) | \$ 22.92 |
| Nonvested at March 31, 2011 | 2,140,551 | \$ 22.34 |

The total fair value of restricted shares vested during the three months ended March 31, 2011 and 2010 was approximately \$7.1 million and \$5.4 million, respectively.

Stock Appreciation Rights

During 2009, the Company began granting cash-settled stock appreciation rights (SARs) to many of its employees. SARs generally vest over a graduated five-year period and expire seven years from the date of grant, unless such expiration occurs sooner due to the employee's termination of employment, as provided in the applicable SAR award agreement. SARs allow the holder to receive cash (less applicable tax withholding) upon the holder's exercise, equal to the excess, if any, of the market price of the Company's Class A common stock on the exercise date over the exercise price, multiplied by the number of shares relating to the SAR with respect to which the SAR is exercised. The exercise price of the SAR is the fair market value of a share of the Company's Class A common stock relating to the SAR on the date of grant. The total value of the SAR is expensed over the service period of the employee receiving the grant, and a liability is recognized in the Company's condensed consolidated balance sheets until settled. The fair value of SARs is required to be remeasured at the end of each reporting period until the award is settled, and changes in fair value must be recognized as compensation expense to the extent of vesting each reporting period based on the new fair value. As of March 31, 2011, the total measured amount of unrecognized compensation cost related to outstanding SARs, to be recognized as expense subsequent to March 31, 2011, based on the remeasurement at March 31, 2011, was approximately \$36.2 million, and the related weighted average period over which it is expected to be recognized is approximately 3.4 years. Included in the \$36.2 million of total measured unrecognized compensation cost related to outstanding SARs is \$4.6 million related to discontinued operations.

The fair value of each SAR was estimated on the date of the grant, and was remeasured at quarter-end, using the Black-Scholes option pricing model with the following assumptions:

| | SARs Granted During the Three Months Ended March 31, 2011 | SARs Granted During the Three Months Ended March 31, 2010 | Remeasurement as of March 31, 2011 |
|-------------------------|--|--|---|
| Expected dividend yield | 0.87% | 1.06% | 1.00% |

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| | | | |
|---------------------------------|-----------|-----------|------------------|
| Expected stock price volatility | 0.32 | 0.33 | 0.33 |
| Risk-free interest rate | 3.12% | 3.04% | 2.90% |
| Expected life of SARs | 7.0 Years | 7.0 Years | 4.9 to 6.9 Years |

The weighted average fair value of SARs granted during the three months ended March 31, 2011 and 2010, as of the respective grant dates, was \$9.90 and \$8.10, respectively. The weighted average fair value of all SARs outstanding as of the remeasurement date of March 31, 2011 was \$17.46.

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A summary of SARs activity for the three months ended March 31, 2011 is as follows:

| | Number of SARs | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|------------------------------|---------------------------|--|--|--|
| Balance at December 31, 2010 | 3,030,142 | \$ 16.99 | | |
| Granted | 48,985 | \$ 27.56 | | |
| Exercised | (35,682) | \$ 14.04 | | |
| Terminated/expired | (84,828) | \$ 15.30 | | |
| Balance at March 31, 2011 | 2,958,617 | \$ 17.25 | 5.4 | \$ 43,756,601 |

The intrinsic value of SARs exercised during the three months ended March 31, 2011 was \$606,400.

As of March 31, 2011, 313,006 SARs were exercisable, with a weighted average exercise price of \$15.65, a weighted average remaining contractual term of 5.3 years, and an aggregate intrinsic value of \$5,129,968.

Total share-based compensation expense related to continuing operations recognized during the three months ended March 31, 2011 and 2010 was as follows (in thousands):

| | Three Months Ended | |
|--|-------------------------------|---------------------------|
| | March 31, 2011 | March 31, 2010 |
| Stock options | \$ 250 | \$ 453 |
| Restricted stock awards | 2,602 | 1,884 |
| Stock appreciation rights | 3,837 | 605 |
| Total share-based compensation expense | \$ 6,689 | \$ 2,942 |

4. SHORT-TERM AND LONG-TERM INVESTMENTS

The Company's policy for its short-term and long-term investments is to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company's investment guidelines and market conditions. Short-term and long-term investments consist of corporate and various government agency and municipal debt securities. The Company's investments in auction rate floating securities consist of investments in student loans. Management classifies the Company's short-term and long-term investments as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses reported in stockholders' equity. Realized gains and losses and declines in value judged to be other than temporary, if any, are included in other expense in the condensed consolidated statement of operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary, results in impairment of the fair value of the investment. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security. Dividends and interest income are recognized when earned. The cost of securities sold is

calculated using the specific identification method. At March 31, 2011, the Company has recorded the estimated fair value of available-for-sale securities in short-term and long-term investments of approximately \$468.7 million and \$32.2 million, respectively.

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Available-for-sale securities consist of the following at March 31, 2011 (in thousands):

| | March 31, 2011 | | | | |
|----------------------------------|-----------------------|---------------------------------------|--|--|-----------------------|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Other-Than- Temporary Impairment Losses | Fair Value |
| Corporate notes and bonds | \$ 182,089 | \$ 388 | \$ (64) | \$ | \$ 182,413 |
| Federal agency notes and bonds | 264,011 | 695 | (76) | | 264,630 |
| Auction rate floating securities | 27,475 | | (6,703) | | 20,772 |
| Asset-backed securities | 33,081 | 22 | | | 33,103 |
| Total securities | \$ 506,656 | \$ 1,105 | \$ (6,843) | \$ | \$ 500,918 |

During the three months ended March 31, 2011, there were no gross realized gains and losses on sales of available-for-sale securities. Gross unrealized gains and losses are determined based on the specific identification method. The net adjustment to unrealized gains during the three months ended March 31, 2011, on available-for-sale securities included in stockholders' equity totaled \$0.1 million. The amortized cost and estimated fair value of the available-for-sale securities at March 31, 2011, by maturity, are shown below (in thousands):

| | March 31, 2011 | |
|---------------------------------------|-----------------------|---------------------------------|
| | Cost | Estimated Fair Value |
| Available-for-sale | | |
| Due in one year or less | \$ 300,290 | \$ 301,192 |
| Due after one year through five years | 178,891 | 178,954 |
| Due after 10 years | 27,475 | 20,772 |
| | \$ 506,656 | \$ 500,918 |

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations. At March 31, 2011, approximately \$32.2 million in estimated fair value expected to mature greater than one year has been classified as long-term investments since these investments are in an unrealized loss position, and management has both the ability and intent to hold these investments until recovery of fair value, which may be maturity.

As of March 31, 2011, the Company's investments included auction rate floating securities with a fair value of \$20.8 million. The Company's auction rate floating securities are debt instruments with a long-term maturity and with an interest rate that is reset in short intervals through auctions. The negative conditions in the credit markets during 2008, 2009, 2010 and the first quarter of 2011 have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008, the Company was informed that there was insufficient demand at auction for the auction rate floating securities. As a result, these affected auction rate floating securities are now considered illiquid, and the Company could be required to hold them until they are redeemed by the holder at maturity. The Company may not be able to liquidate the securities until a future auction on these investments is successful.

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

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charge was therefore recorded in other expense, net, during the three months ended March 31, 2010 related to the asset-backed security. The asset-backed security was sold in April 2010.

The following table shows the gross unrealized losses and the fair value of the Company's investments, with unrealized losses that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2011 (in thousands):

| | Less Than 12 Months | | Greater Than 12 Months | |
|----------------------------------|---------------------|-----------------------|------------------------|-----------------------|
| | Fair Value | Gross Unrealized Loss | Fair Value | Gross Unrealized Loss |
| Corporate notes and bonds | \$ 44,724 | \$ 64 | \$ | \$ |
| Federal agency notes and bonds | 18,425 | 76 | | |
| Auction rate floating securities | | | 20,772 | 6,703 |
| Asset-backed securities | 2,499 | | | |
| Total securities | \$ 65,648 | \$ 140 | \$ 20,772 | \$ 6,703 |

As of March 31, 2011, the Company has concluded that the unrealized losses on its investment securities are temporary in nature and are caused by changes in credit spreads and liquidity issues in the marketplace. Available-for-sale securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security's performance and the creditworthiness of the issuer. Additionally, the Company does not intend to sell and it is not more-likely-than-not that the Company will be required to sell any of the securities before the recovery of their amortized cost basis.

5. FAIR VALUE MEASUREMENTS

As of March 31, 2011, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included certain of the Company's short-term and long-term investments, including investments in auction rate floating securities.

The Company has invested in auction rate floating securities, which are classified as available-for-sale securities and reflected at fair value. Due to events in credit markets, the auction events for some of these instruments held by the Company failed during the three months ended March 31, 2008 (see Note 4). Therefore, the fair values of these auction rate floating securities, which are primarily rated AAA, are estimated utilizing a discounted cash flow analysis as of March 31, 2011. These analyses consider, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These investments were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company. Changes to these assumptions in future periods could result in additional declines in fair value of the auction rate floating securities.

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The Company's assets measured at fair value on a recurring basis subject to the disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, at March 31, 2011, were as follows (in thousands):

| | Mar. 31, 2011 | Fair Value Measurement at Reporting Date | | |
|-------------------------------------|------------------|---|---|--|
| | | Quoted Prices in Active Markets (Level 1) | Using Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Corporate notes and bonds | \$ 182,413 | \$ 182,413 | \$ | \$ |
| Federal agency notes and bonds | 264,630 | 264,630 | | |
| Auction rate floating securities | 20,772 | | | 20,772 |
| Asset-backed securities | 33,103 | 33,103 | | |
| Total assets measured at fair value | \$ 500,918 | \$ 480,146 | \$ | \$ 20,772 |

The following tables present the Company's assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2011 (in thousands):

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Floating Securities |
|--|--|
| Balance at December 31, 2010 | \$ 21,480 |
| Transfers to (from) Level 3 | |
| Total gains (losses) included in other (income) expense, net | |
| Total gains included in other comprehensive income | 392 |
| Purchases | |
| Settlements | (1,100) |
| Balance at March 31, 2011 | \$ 20,772 |

6. RESEARCH AND DEVELOPMENT

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

The Company's policy on accounting for costs of strategic collaborations determines the timing of the recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or capitalized as an asset. Management is required to form judgments with respect to the commercial status of such products in determining whether development costs meet the criteria for immediate expense or capitalization. For example, when the Company acquires certain products for which there is already an Abbreviated New Drug Application (ANDA) or a New Drug Application (NDA) approval related directly to the product, and there is net realizable value based on projected sales for these products, the Company capitalizes the amount paid as an intangible asset. If the Company acquires product rights which are in the development phase and

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

Research and development expense for the three months ended March 31, 2011 and 2010 are as follows (in thousands):

| | Three Months Ended | |
|--|----------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Ongoing research and development costs | \$ 6,868 | \$ 6,503 |
| Payments related to strategic collaborations | 7,000 | |
| Share-based compensation expense | 405 | 55 |
| Total research and development | \$ 14,273 | \$ 6,558 |

7. STRATEGIC COLLABORATIONS*Anacor*

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

8. SEGMENT AND PRODUCT INFORMATION

The Company operates in one business segment: pharmaceuticals. The Company's current pharmaceutical franchises are divided between the dermatological and non-dermatological fields. The dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. The non-dermatological field represents products for the treatment of urea cycle disorder and contract revenue. The acne and acne-related dermatological product lines include DYNACIN[®], PLEXION[®], SOLODYN[®], TRIAZ[®] and ZIANA[®]. During early 2011, the Company discontinued its TRIAZ[®] branded products and decided to no longer promote its PLEXION[®] branded products. The non-acne dermatological product lines include DYSPORT[®], LOPROX[®], PERLANE[®], RESTYLANE[®] and VANOS[®]. The non-dermatological product lines include AMMONUL[®] and BUPHENYL[®]. The non-dermatological field also includes contract revenues associated with licensing agreements and authorized generics.

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

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

| | Three Months Ended | |
|---|--------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Acne and acne-related dermatological products | \$103,462 | \$120,213 |
| Non-acne dermatological products | 52,221 | 34,252 |
| Non-dermatological products | 9,230 | 11,077 |
| Total net revenues | \$164,913 | \$165,542 |

| | Three Months Ended | |
|---|----------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Acne and acne-related dermatological products | 63% | 72% |
| Non-acne dermatological products | 32 | 21 |
| Non-dermatological products | 5 | 7 |
| Total net revenues | 100% | 100% |

9. INVENTORIES

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

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

Inventories are as follows (in thousands):

| | March 31, 2011 | December 31, 2010 |
|-----------------|-------------------|----------------------|
| Raw materials | \$ 13,803 | \$ 15,801 |
| Work-in-process | 3,478 | 3,236 |

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| | | |
|-------------------|-----------|-----------|
| Finished goods | 26,010 | 24,838 |
| Valuation reserve | (8,887) | (8,593) |
| Total inventories | \$ 34,404 | \$ 35,282 |

Table of Contents**10. OTHER CURRENT LIABILITIES**

Other current liabilities are as follows (in thousands):

| | March 31, 2011 | December 31, 2010 |
|--|---------------------------|------------------------------|
| Accrued incentives, including SARs liability | \$ 24,641 | \$ 33,923 |
| Deferred revenue | 14,230 | 16,422 |
| Other accrued expenses | 28,636 | 24,883 |
| | \$ 67,507 | \$ 75,228 |

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

| | March 31, 2011 | December 31, 2010 |
|---|---------------------------|------------------------------|
| Deferred revenue – aesthetics products, net of cost of revenue | \$ 7,712 | \$ 10,334 |
| Deferred contract revenue | 2,209 | 3,014 |
| Deferred revenue – sales into distribution channel in excess of eight weeks of projected demand | 4,217 | 582 |
| Other deferred revenue | 92 | 2,492 |
| | \$ 14,230 | \$ 16,422 |

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

11. CONTINGENT CONVERTIBLE SENIOR NOTES

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

The Company may redeem some or all of the Old Notes at any time on or after June 11, 2007, at a redemption price, payable in cash, of 100% of the principal amount of the Old Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the Old Notes may require the Company to repurchase all or a portion of their Old Notes on June 4, 2012 and June 4, 2017, or upon a change in control, as defined in the indenture governing the Old Notes, at 100% of the principal amount of the Old Notes, plus accrued and unpaid interest to the date of the repurchase, payable in cash. Under GAAP, if an obligation is due on demand or will be due on demand within one year from the balance sheet date, even though liquidation may not be expected within that period, it should be classified as a current liability. Accordingly, the outstanding balance of Old Notes along with the deferred tax liability

associated with accelerated interest deductions on the Old Notes will be classified as a current liability during the respective twelve month periods prior to June 4, 2012 and June 4, 2017.

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

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

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

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

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

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

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

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

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

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

if the Company has called the New Notes for redemption;

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

upon the occurrence of specified corporate transactions.

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

During the quarters ended March 31, 2011 and December 31, 2010, the Old Notes and New Notes did not meet the criteria for the right of conversion. At the end of each future quarter, the conversion rights will be reassessed in accordance with the bond indenture agreement to determine if the conversion trigger rights have been achieved.

12. INCOME TAXES

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

At March 31, 2011, the Company has an unrealized tax loss of \$21.0 million related to the Company's option to acquire Revance or license Revance's topical product that is under development. The Company will not be able to determine the character of the loss until the Company exercises or fails to exercise its option. A realized loss characterized as a capital loss can only be utilized to offset capital gains. At March 31, 2011, the Company has recorded a valuation allowance of \$7.6 million against the deferred tax asset associated with this unrealized tax loss in order to reduce the carrying value of the deferred tax asset to \$0, which is the amount that management believes is more likely than not to be realized.

At March 31, 2011, the Company has an unrealized tax loss of \$16.4 million related to the Company's option to acquire a privately-held U.S. biotechnology company. If the Company fails to exercise its option, a capital loss will be recognized. A loss characterized as a capital loss can only be used to offset capital gains. At March 31,

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2011, the Company has recorded a valuation allowance of \$5.9 million against the deferred tax asset associated with this unrealized tax loss in order to reduce the carrying value of the deferred tax asset to \$0, which is the amount that management believes is more likely than not to be realized.

During the three months ended March 31, 2011 and March 31, 2010, the Company made net tax payments of \$6.0 million and \$16.8 million, respectively.

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

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

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

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

13. DIVIDENDS DECLARED ON COMMON STOCK

On March 22, 2011, the Company announced that its Board of Directors had declared a cash dividend of \$0.08 per issued and outstanding share of the Company's Class A common stock, which was paid on April 29, 2011, to stockholders of record at the close of business on April 1, 2011. The \$4.9 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 March 31, 2011. The Company has not adopted a dividend policy.

14. COMPREHENSIVE INCOME

Total comprehensive income includes net income and other comprehensive income (loss), 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 March 31, 2011 and 2010, was \$19.6 million and \$35.9 million, respectively.

Table of Contents**15. NET INCOME PER COMMON SHARE**

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

| | March 31, 2011 | | Three Months Ended | | March 31, 2010 | |
|---|-----------------------|-------------------------|--------------------|-----------------------|-------------------------|------------|
| | Continuing Operations | Discontinued Operations | Net Income | Continuing Operations | Discontinued Operations | Net Income |
| BASIC | | | | | | |
| Net income (loss) | \$ 26,685 | \$ (7,325) | \$ 19,360 | \$ 40,022 | \$ (4,650) | \$ 35,372 |
| Less: income (loss) allocated to participating securities | 799 | | 562 | 1,318 | | 1,163 |
| Net income (loss) available to common stockholders | 25,886 | (7,325) | 18,798 | 38,704 | (4,650) | 34,209 |
| Weighted average number of common shares outstanding | 59,124 | 59,124 | 59,124 | 58,049 | 58,049 | 58,049 |
| Basic net income (loss) per common share | \$ 0.44 | \$ (0.12) | \$ 0.32 | \$ 0.67 | \$ (0.08) | \$ 0.59 |
| DILUTED | | | | | | |
| Net income (loss) | \$ 26,685 | \$ (7,325) | \$ 19,360 | \$ 40,022 | \$ (4,650) | \$ 35,372 |
| Less: income (loss) allocated to participating securities | 799 | | 562 | 1,318 | | 1,163 |
| Net income (loss) available to common stockholders | 25,886 | (7,325) | 18,798 | 38,704 | (4,650) | 34,209 |
| Less: Undistributed earnings allocated to unvested stockholders | (687) | | (457) | (1,211) | | (1,057) |
| Add: Undistributed earnings re-allocated to unvested stockholders | 683 | | 454 | 1,205 | | 1,051 |
| Add: Tax-effected interest expense and issue costs related to Old Notes | 666 | | 666 | 666 | | 666 |

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| | | | | | | |
|--|-----------|------------|-----------|-----------|------------|-----------|
| Net income (loss) assuming dilution | \$ 26,548 | \$ (7,325) | \$ 19,461 | \$ 39,364 | \$ (4,650) | \$ 34,869 |
| Weighted average number of common shares outstanding | 59,124 | 59,124 | 59,124 | 58,049 | 58,049 | 58,049 |
| Effect of dilutive securities: | | | | | | |
| Old Notes | 5,823 | | 5,823 | 5,823 | | 5,823 |
| New Notes | 4 | | 4 | 4 | | 4 |
| Stock options | 430 | | 430 | 316 | | 316 |
| Weighted average number of common shares assuming dilution | 65,381 | 59,124 | 65,381 | 64,192 | 58,049 | 64,192 |
| Diluted net income (loss) per common share | \$ 0.41 | \$ (0.12) | \$ 0.30 | \$ 0.61 | \$ (0.08) | \$ 0.54 |

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

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

The diluted net income per common share computation for the three months ended March 31, 2011 and 2010 excludes 5,032,879 and 8,483,156 shares of stock, respectively, that represented outstanding stock options whose impact would be anti-dilutive.

Due to the net loss from discontinued operations during the three months ended March 31, 2011 and 2010, diluted earnings per share and basic earnings per share from discontinued operations are the same, as the effect of potentially dilutive securities would be anti-dilutive.

16. COMMITMENTS AND CONTINGENCIES**Legal Matters**

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

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

Impax SOLODYN[®] Litigation and Settlement

On November 26, 2008, the Company and Impax Laboratories, Inc. (Impax) entered into a Settlement and License Agreement (the First Impax Settlement Agreement) that terminated all legal disputes between them relating to SOLODYN[®]. Under the terms of the First Impax Settlement Agreement, Impax will have a license to market its generic versions of SOLODYN[®] in 45mg, 90mg and 135mg strengths under the SOLODYN[®] intellectual property rights belonging to the Company upon the occurrence of certain events and no later than November 2011. On June 23, 2009, the Company and Impax entered into a second Settlement Agreement (the Second Impax Settlement Agreement) and an Amendment No. 2 to the First Impax Settlement Agreement. Pursuant to the Second Impax Settlement Agreement, both Impax and the Company released, acquitted, covenanted not to sue and forever discharged one another and their affiliates from any and all liabilities relating to the litigation that Impax commenced after the First Impax Settlement Agreement. On July 27, 2010, Impax filed an action in the Superior Court of the State of Arizona in and for the County of Maricopa seeking a declaration that certain rights of Impax under the First and Second Impax Settlement Agreements have been triggered. Impax filed an amended complaint and the Company filed counterclaims against Impax. On January 21, 2011, the Company and Impax entered into a Settlement Agreement (the

Third Impax Settlement Agreement) which terminated the disputes between the Company and Impax relating to the First and Second Impax Settlement Agreements. The Third Impax Settlement Agreement also amended certain provisions of the Joint Development Agreement between the Company and Impax.

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The parties filed a stipulation to dismiss with prejudice all claims in the amended complaint and the counterclaims. On February 4, 2011, the Court granted the order dismissing the action in its entirety with prejudice.

Genzyme RESTYLANE®/PERLANE® Litigation

On October 15, 2010, the Company received notice that Genzyme Corporation (Genzyme) had filed a lawsuit against the Company in the United States District Court for the District of Massachusetts alleging that the Company has infringed, contributorily infringed and/or induced the infringement by others of one or more claims of Genzyme's U.S. Patent No. 5,399,351 by using, selling, offering to sell and/or importing RESTYLANE®, PERLANE®, RESTYLANE-L® and/or PERLANE-L® (the RESTYLANE® family of products) in the United States and/or advising others with respect to such activities. The Company acquired exclusive U.S. and Canadian rights to the RESTYLANE® family of products through certain license agreements with Q-Med AB, a Swedish biotechnology and medical device company and its affiliates (collectively Q-Med), in March 2003, and first launched RESTYLANE® in January 2004 following approval by the FDA in December 2003. PERLANE® was approved by the FDA and launched in May 2007. RESTYLANE-L® and PERLANE-L® were approved by the FDA in January 2010 and launched in February 2010. The RESTYLANE® family of products is covered by a U.S. patent that expires in 2015 or later. Pursuant to the Company's license agreement with Q-Med, Q-Med elected to assume the defense of Genzyme's claim. On February 14, 2011, Q-Med, the Company and Genzyme entered into a written settlement agreement whereby none of the parties admits any liability or wrongdoing relating to the claims in the lawsuit, and pursuant to which Genzyme has agreed to dismiss the case and release the Company and Q-Med from any liability relating to the lawsuit, and has also agreed to a certain covenant not to sue in exchange for a lump sum payment by Q-Med to Genzyme. The Company is not required to make any payment to Genzyme or Q-Med under the terms of the settlement agreement. Pursuant to the settlement agreement entered into among the parties, the Court dismissed this action on February 22, 2011.

Stockholder Class Action Litigation

On October 3, 10 and 27, 2008, purported stockholder class action lawsuits styled Andrew Hall v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01821-MHB); Steamfitters Local 449 Pension Fund v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01870-DKD); and Darlene Oliver v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01964-JAT) were filed in the United States District Court for the District of Arizona on behalf of stockholders who purchased securities of the Company during the period between October 30, 2003 and approximately September 24, 2008. The Court consolidated these actions into a single proceeding and on May 18, 2009 an amended complaint was filed alleging violations of the federal securities laws arising out of the Company's restatement of its consolidated financial statements in 2008. On December 2, 2009, the Court granted the Company's and other defendants' dismissal motions and dismissed the consolidated amended complaint without prejudice. On January 18, 2010 the lead plaintiff filed a second amended complaint, and on or about August 9, 2010, the Court denied the Company's and other defendants' related dismissal motions. On December 17, 2010, the lead plaintiff filed a motion for class certification, and the defendants filed an opposition to the motion on March 8, 2011. The Company is in active discussions with the plaintiffs in the lawsuit, as well as the plaintiffs in the derivative lawsuits described below, in pursuit of a collective resolution of the class action and the derivative lawsuits. The parties have agreed to stay the class action plaintiffs' reply in support of the motion for class action certification pending final settlement. In the event the matter is not settled, the Company will continue to vigorously defend the claims in the class action and derivative lawsuits. There can be no assurance that the Company will be successful in its settlement discussions or in defending the lawsuits, and an adverse resolution of the lawsuits could have a material adverse effect on the Company's financial position and results of operations in the period in which the lawsuits are resolved.

Stockholder Derivative Lawsuits

On January 21, 2009, the Company received a letter from an alleged stockholder demanding that its Board of Directors take certain actions, including potentially legal action, in connection with the restatement of its consolidated financial statements in 2008. The letter stated that, if the Board of Directors did not take the demanded action, the alleged stockholder would commence a derivative action on behalf of the Company. The Company's Board of Directors reviewed the letter during the course of 2009 and established a special committee of the Board of Directors, comprised of directors who are independent and disinterested with respect to the allegations in the letter, to assess the

allegations contained in the letter. The special committee engaged outside counsel to assist with the investigation. The special committee completed its investigation, and on or about February 16, 2010, the Board of

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Directors, pursuant to the report and recommendation of the special committee, resolved to decline the derivative demand. On February 26, 2010, Company counsel sent a declination letter to opposing counsel. On or about October 21, 2010, the stockholder filed a derivative complaint against the Company and its directors and certain officers in the Superior Court of the State of Arizona in and for the County of Maricopa, alleging that such individuals breached their fiduciary duties to the Company in connection with the restatement. The stockholder seeks to recover unspecified damages and costs, including counsel and expert fees.

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

The Company is in active discussions with the plaintiffs in both derivative lawsuits, as well as the plaintiffs in the class action lawsuit described above, in pursuit of a collective resolution of the derivative and class action lawsuits. The Company and the plaintiffs in the derivative lawsuits have agreed to stay the derivative lawsuits pending final settlement. In the event the lawsuits are not settled and the stay is lifted, the Company will continue to vigorously defend the claims in the derivative and class action lawsuits. There can be no assurance that the Company will be successful in its settlement discussions or in defending the lawsuits, and an adverse resolution of the lawsuits could have a material adverse effect on the Company's financial position and results of operations in the period in which the lawsuits are resolved.

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

17. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In October 2009, the FASB approved for issuance Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (ASC 605) Multiple Deliverable Revenue Arrangements*, a consensus of EITF 08-01, *Revenue Arrangements with Multiple Deliverables*. This guidance modifies the fair value requirements of ASC subtopic 605-25 *Revenue Recognition Multiple Element Arrangements* by providing principles for allocation of consideration among its multiple-elements, allowing more flexibility in identifying and accounting for separate deliverables under an arrangement. An estimated selling price method is introduced for valuing the elements of a bundled arrangement if vendor-specific objective evidence or third-party evidence of selling price is not available, and significantly expands related disclosure requirements. This updated guidance is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Alternatively, adoption may be on a retrospective basis, and early application is permitted. The adoption of the guidance on January 1, 2011 did not have a material impact on the Company's results of operations and financial condition.

In March 2010, the FASB approved for issuance ASU No. 2010-17, *Revenue Recognition-Milestone Method (Topic 605): Milestone Method of Revenue Recognition*. The updated guidance recognizes the milestone method as an acceptable revenue recognition method for substantive milestones in research or development transactions, and is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. The adoption of the guidance on January 1, 2011 did not have a material impact on the Company's results of operations and financial condition.

18. SUBSEQUENT EVENTS

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

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations***Executive Summary*

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

Our current product lines are divided between the dermatological and non-dermatological fields. The dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. The non-dermatological field represents products for the treatment of urea cycle disorder and contract revenue. Our acne and acne-related dermatological product lines include DYNACIN[®], PLEXION[®], SOLODYN[®], TRIAZ[®] and ZIANA[®]. During early 2011, we discontinued our TRIAZ[®] branded products and decided to no longer promote our PLEXION[®] branded products. Our non-acne dermatological product lines include DYSPORT[®], LOPROX[®], PERLANE[®], RESTYLANE[®] and VANOS[®]. Our non-dermatological product lines include AMMONUL[®] and BUPHENYL[®]. Our non-dermatological field also includes contract revenues associated with licensing agreements and authorized generic agreements.

Financial Information About Segments

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

Key Aspects of Our Business

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

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

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

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

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

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

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

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

Recent Developments

As described in more detail below, the following significant events and transactions occurred during the three months ended March 31, 2011, and affected our results of operations, our cash flows and our financial condition:

Research and development agreement with Anacor;

Settlement Agreement with Teva;

Classification of LipoSonix as a discontinued operation; and

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

Research and development agreement with Anacor

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

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

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Settlement Agreement with Teva

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

Classification of LipoSonix as a discontinued operation

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

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

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

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Results of Operations

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

| | Three Months Ended March 31, 2011 | March 31, 2010 |
|--|--|---------------------------|
| | (a) | (b) |
| Net revenues | 100.0% | 100.0% |
| Gross profit (c) | 91.3 | 90.9 |
| Operating expenses | 64.4 | 51.7 |
| Operating income | 26.9 | 39.2 |
| Other expense, net | | (0.2) |
| Interest and investment (expense) income, net | 0.1 | 0.1 |
| Income from continuing operations before income tax expense | 27.0 | 39.1 |
| Income tax expense | (10.8) | (14.9) |
| Net income from continuing operations | 16.2 | 24.2 |
| Loss from discontinued operations, net of income tax benefit | (4.4) | (2.8) |
| Net income | 11.8% | 21.4% |

- (a) Included in operating expenses is \$7.0 million (4.2% of net revenues) paid to Anacor related to a product development agreement and \$6.7 million (4.1% of net revenues) of compensation expense related to stock options, restricted stock and stock appreciation rights.
- (b) Included in operating expenses is \$2.9 million (1.8% of net revenues) of compensation expense related to stock options, restricted stock and stock appreciation rights.
- (c) Gross profit does not include amortization of the related intangibles as such expense is included in operating expenses.

Table of Contents*Three Months Ended March 31, 2011 Compared to the Three Months Ended March 31, 2010**Net Revenues*

The following table sets forth our net revenues for the three months ended March 31, 2011 (the first quarter of 2011) and March 31, 2010 (the first quarter of 2010), along with the percentage of net revenues and percentage point change for each of our product categories (dollar amounts in millions):

| | First Quarter 2011 | First Quarter 2010 | \$ Change | % Change |
|-----------------------|--------------------------|-----------------------|-----------|----------|
| Net product revenues | \$163.9 | \$163.6 | \$0.3 | 0.2% |
| Net contract revenues | 1.0 | 1.9 | (0.9) | (47.4)% |
| Total net revenues | \$164.9 | \$165.5 | \$(0.6) | (0.4)% |

| | First Quarter 2011 | First Quarter 2010 | \$ Change | % Change |
|---|--------------------------|-----------------------|-----------|----------|
| Acne and acne-related dermatological products | \$103.5 | \$120.2 | \$(16.7) | (13.9)% |
| Non-acne dermatological products | 52.2 | 34.2 | 18.0 | 52.6% |
| Non-dermatological products (including contract revenues) | 9.2 | 11.1 | (1.9) | (17.1)% |
| Total net revenues | \$164.9 | \$165.5 | \$(0.6) | (0.4)% |

| | First Quarter 2011 | First Quarter 2010 | Change |
|---|--------------------------|--------------------------|--------|
| Acne and acne-related dermatological products | 62.7% | 72.6% | (9.9)% |
| Non-acne dermatological products | 31.7% | 20.7% | 11.0% |
| Non-dermatological products (including contract revenues) | 5.6% | 6.7% | (1.1)% |
| Total net revenues | 100.0% | 100.0% | |

Net revenues associated with our acne and acne-related dermatological products decreased by \$16.7 million, or 13.9%, during the first quarter of 2011 as compared to the first quarter of 2010 primarily as a result of a decrease in net revenues of SOLODYN[®], TRIAZ[®] and ZIANA[®]. The decrease in net revenues of SOLODYN[®] was primarily the result of increased reserves for returns and reserves for consumer rebates, partially offset by an increase in gross sales of SOLODYN[®] due to increased demand and the FDA approval of new 55mg, 80mg and 105mg strengths of SOLODYN[®] on August 27, 2010. The decrease in net revenues of TRIAZ[®] was primarily due to our early 2011 discontinuation of TRIAZ[®] as a result of the FDA's requirement that, effective March 4, 2011, prescription benzoyl peroxide products that are not approved through a New Drug Application, such as TRIAZ[®], not be sold as prescription products. The decrease in net revenues of ZIANA[®] was primarily due to a \$3.9 million reserve recorded during the first quarter of 2011 related to a targeted recall of product from one lot, as a result of a notice we received during

April 2011 from our contract manufacturer regarding one lot of ZIANA® that went out of specifications.

Net revenues associated with our non-acne dermatological products increased by \$18.0 million, or 52.6% during the first quarter of 2011 as compared to the first quarter of 2010, primarily due to increased sales of DYSPORT®, RESTYLANE® and VANOS®, partially offset by a decrease in sales of LOPROX®, which was

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negatively impacted by generic competition. RESTYLANE-L[®] and PERLANE-L[®] were launched during February 2010 following FDA approval on January 29, 2010.

Net revenues associated with our non-dermatological products decreased by \$1.9 million, or 17.1%, during the first quarter of 2011 as compared to the first quarter of 2010 primarily due to a decrease in sales of BUPHENYL[®] and contract revenues.

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 products sold is not included in gross profit. Amortization expense related to these intangibles for the first quarter of 2011 and 2010 was approximately \$5.5 million and \$5.2 million, respectively. Product 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 2011 and 2010, along with the percentage of net revenues represented by such gross profit (dollar amounts in millions):

| | First Quarter 2011 | First Quarter 2010 | \$ Change | % Change |
|-------------------|-----------------------|-----------------------|-----------|----------|
| Gross profit | \$ 150.6 | \$ 150.4 | \$0.2 | 0.1% |
| % of net revenues | 91.3% | 90.9% | | |

Selling, General and Administrative Expenses

The following table sets forth our selling, general and administrative expenses for the first quarter of 2011 and 2010, along with the percentage of net revenues represented by selling, general and administrative expenses (dollar amounts in millions):

| | First Quarter 2011 | First Quarter 2010 | \$ Change | % Change |
|---|-----------------------|-----------------------|-----------|----------|
| Selling, general and administrative | \$ 84.6 | \$ 72.3 | \$12.3 | 17.0% |
| % of net revenues | 51.3% | 43.7% | | |
| Share-based compensation expense included in selling, general and administrative | \$ 6.3 | \$ 2.9 | \$ 3.4 | 117.2% |

Selling, general and administrative expenses increased \$12.3 million, or 17.0%, during the first quarter of 2011 as compared to the first quarter of 2010, and increased as a percentage of net revenues from 43.7% during the first quarter of 2010 to 51.3% during the first quarter of 2011. Included in this increase was a \$8.5 million increase in personnel expenses, including a \$3.4 million increase in stock compensation expense, primarily related to the revaluation of stock appreciation rights (SARs) awards based on changes in the market price of our common stock, a \$2.5 million increase in professional and consulting costs and an increase of \$1.3 million of other selling, general and administrative costs.

Table of Contents*Research and Development Expenses*

The following table sets forth our research and development expenses for the first quarter of 2011 and 2010 (dollar amounts in millions):

| | First Quarter 2011 | First Quarter 2010 | \$ Change | % Change |
|---|-----------------------|-----------------------|-----------|----------|
| Research and development | \$ 14.3 | \$ 6.6 | \$7.7 | 116.7% |
| Charges included in research and development | \$ 7.0 | \$ | \$7.0 | 100.0% |
| Share-based compensation expense included in research and development | \$ 0.4 | \$ 0.1 | \$0.3 | 300.0% |

Included in research and development expenses for the first quarter of 2011 was a \$7.0 million payment to Anacor related to a product development agreement. We expect research and development expenses to continue 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 2011 were \$7.3 million, as compared to \$6.7 million during the first quarter of 2010, primarily due to increased depreciation expense for property and equipment.

Interest and Investment Income

Interest and investment income during the first quarter of 2011 increased \$0.1 million, or 9.8%, to \$1.3 million from \$1.2 million during the first quarter of 2010, due to an increase in the amount of funds available for investment during the first quarter of 2011.

Interest Expense

Interest expense during the first quarter of 2011 and the first quarter of 2010 was \$1.1 million. Our interest expense during the first quarter of 2011 and 2010 consisted of interest expense on our Old Notes, which accrue interest at 2.5% per annum, and our New Notes, which accrue interest at 1.5% per annum. See Note 11 in our accompanying condensed consolidated financial statements for further discussion on the Old Notes and New Notes.

Other Expense, net

Other expense of \$0.3 million recognized during the first quarter of 2010 represented an other-than-temporary impairment on an asset-backed security investment.

Income Tax Expense

Our effective tax rate for continuing operations for the first quarter of 2011 was 40.1%, as compared to 38.1% for the first quarter of 2010.

Loss from Discontinued Operations, Net of Income Tax Benefit

Loss from discontinued operations, net of income tax benefit, was \$7.3 million during the first quarter of 2011, as compared to \$4.6 million during the first quarter of 2010. See Note 2 in our accompanying condensed consolidated financial statements for further discussion.

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Liquidity and Capital Resources

Overview

The following table highlights selected cash flow components for the first quarter of 2011 and 2010, and selected balance sheet components as of March 31, 2011 and December 31, 2010 (dollar amounts in millions):

| | First Quarter 2011 | First Quarter 2010 | \$ Change | % Change |
|--|-----------------------|-----------------------|-----------|----------|
| Cash provided by (used in): | | | | |
| Operating activities | \$ 91.2 | \$ 38.2 | \$ 53.0 | 138.7% |
| Investing activities | (9.4) | (142.0) | 132.6 | 93.4% |
| Financing activities | 6.5 | (1.3) | 7.8 | 600.0% |
| | Mar. 31, 2011 | Dec. 31, 2010 | \$ Change | % Change |
| Cash, cash equivalents, and short-term investments | \$ 775.5 | \$ 703.6 | \$71.9 | 10.2% |
| Working capital | 638.6 | 628.4 | 10.2 | 1.6% |
| Long-term investments | 32.2 | 21.5 | 10.7 | 49.8% |
| 2.5% contingent convertible senior notes due 2032 | 169.1 | 169.1 | | % |
| 1.5% contingent convertible senior notes due 2033 | 0.2 | 0.2 | | % |
| | 31 | | | |

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Working capital as of March 31, 2011 and December 31, 2010, consisted of the following (dollar amounts in millions):

| | Mar. 31, 2011 | Dec. 31, 2010 | \$ Change | % Change |
|--|-----------------|-----------------|----------------|--------------|
| Cash, cash equivalents, and short-term investments | \$ 775.5 | \$ 703.6 | \$ 71.9 | 10.2% |
| Accounts receivable, net | 99.6 | 130.6 | (31.0) | (23.7)% |
| Inventories, net | 34.4 | 35.3 | (0.9) | (2.5)% |
| Deferred tax assets, net | 79.4 | 70.5 | 8.9 | 12.6% |
| Other current assets | 18.1 | 15.2 | 2.9 | 19.1% |
| Assets held for sale from discontinued operations | 10.1 | 13.1 | (3.0) | (22.9)% |
| Total current assets | 1,017.1 | 968.3 | 48.8 | 5.0% |
| Accounts payable | 45.3 | 41.0 | 4.3 | 10.5% |
| Reserve for sales returns | 73.8 | 60.7 | 13.1 | 21.6% |
| Accrued consumer rebate and loyalty programs | 121.7 | 101.7 | 20.0 | 19.7% |
| Managed care and Medicaid reserves | 49.2 | 49.4 | (0.2) | (0.4)% |
| Income taxes payable | 15.1 | 4.6 | 10.5 | 228.3% |
| Other current liabilities | 67.5 | 75.2 | (7.7) | (10.2)% |
| Liabilities held for sale from discontinued operations | 5.9 | 7.3 | (1.4) | (19.2)% |
| Total current liabilities | 378.5 | 339.9 | 38.6 | 11.4% |
| Working capital | \$ 638.6 | \$ 628.4 | \$ 10.2 | 1.6% |

We had cash, cash equivalents and short-term investments of \$775.5 million and working capital of \$638.6 million at March 31, 2011, as compared to \$703.6 million and \$628.4 million, respectively, at December 31, 2010. The increase in cash, cash equivalents and short-term investments was primarily due to the generation of \$91.2 million of operating cash flow during the first quarter of 2011.

Accounts receivable, net, decreased \$31.0 million, or 23.7%, from \$130.6 million at December 31, 2010 to \$99.6 million at March 31, 2011. The decrease was primarily due to a \$14.8 million decrease in gross sales during the month of March 2011 as compared to the month of December 2010. As our standard payment terms are 30 days, orders that occur during the last month of a quarter are typically not due for payment until after the end of the quarter. Gross sales during the month of March 2011 were \$125.6 million, or 36.9% of the total gross sales for the first quarter of 2011, as compared to gross sales during the month of December 2010 of \$140.4 million, or 45.1% of total gross sales for the fourth quarter of 2010. Days sales outstanding, calculated as accounts receivable, net, as of the end of the reporting period, divided by total gross sales for the quarter, multiplied by the number of days in the quarter, was 26 days as of March 31, 2011 as compared to 39 days as of December 31, 2010. The decrease in days sales outstanding was primarily due to the timing of orders placed by customers during the first quarter of 2011 as compared to the fourth quarter of 2010. Although less of the customers purchases during the first quarter of 2011 occurred during the last month of the quarter as compared to the last month of the fourth quarter of 2010, their total purchases for the first quarter of 2011 were consistent with previous quarters. We sell our products primarily to major wholesalers and retail chain drugstores. We have distribution services agreements with our two largest wholesale customers. We review the supply levels of our significant products sold to major wholesalers by reviewing periodic

inventory reports that are supplied to us by our major wholesalers in accordance with the distribution services agreements. We rely wholly upon our wholesale and retail chain drugstore customers to effect the distribution allocation of substantially all of our prescription products. We also defer the recognition of revenue for certain sales of inventory into the distribution channel that are in excess of eight (8) weeks of projected demand,

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and we defer the recognition of revenue of our aesthetics products DYSPO[®], PERLANE[®] and RESTYLANE[®], until our exclusive U.S. distributor, McKesson, ships these products to physicians. There has not been a significant change in inventories in the distribution channel during the quarter ended March 31, 2011.

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. Our cash and short-term investments are available for dividends, milestone payments related to our product development collaborations, strategic investments, acquisitions of companies or products complementary to our business, the repayment of outstanding indebtedness, repurchases of our outstanding securities and other potential large-scale needs. In addition, we may consider incurring additional indebtedness and issuing additional debt or equity securities in the future to fund potential acquisitions or investments, to refinance existing debt or for general corporate purposes. If a material acquisition or investment is completed, our operating results and financial condition could change materially in future periods. However, no assurance can be given that additional funds will be available on satisfactory terms, or at all, to fund such activities.

As of March 31, 2011, our short-term investments included \$20.8 million of auction rate floating securities. Our auction rate floating securities are debt instruments with a long-term maturity and with an interest rate that is reset in short intervals through auctions. During the three months ended March 31, 2008, we were informed that there was insufficient demand at auction for the auction rate floating securities, and since that time we have been unable to liquidate our holdings in such securities. As a result, these affected auction rate floating securities are now considered illiquid, and we could be required to hold them until they are redeemed by the holder at maturity or until a future auction on these investments is successful. During the first quarter of 2011, we liquidated \$1.1 million of our auction rate floating securities at par.

Operating Activities

Net cash provided by operating activities during the first quarter of 2011 was approximately \$91.2 million, compared to cash provided by operating activities of approximately \$38.2 million during the first quarter of 2010. The following is a summary of the primary components of cash provided by operating activities during the first quarter of 2011 and 2010 (in millions):

| | First Quarter 2011 | First Quarter 2010 |
|--|--------------------------|--------------------------|
| Income taxes paid | \$ (6.0) | \$ (16.8) |
| Payment made to Anacor related to development agreement | (7.0) | |
| Decrease (increase) in accounts receivable | 31.5 | (15.5) |
| Increase (decrease) in reserve for returns | 13.1 | (4.3) |
| Increase in other current liabilities | 3.1 | 10.5 |
| Cash used in operating activities from discontinued operations | (5.5) | (3.9) |
| Other cash provided by operating activities | 62.0 | 68.2 |
| Cash provided by operating activities | \$91.2 | \$ 38.2 |

Investing Activities

Net cash used in investing activities during the first quarter of 2011 was approximately \$9.4 million, compared to net cash used in investing activities during the first quarter of 2010 of \$142.0 million. The change was primarily due to the net purchases and sales of our short-term and long-term investments during the respective quarters.

Financing Activities

Net cash provided by financing activities during the first quarter of 2011 was \$6.5 million, compared to net cash used in financing activities of \$1.3 million during the first quarter of 2010. Proceeds from the exercise of stock options were \$9.5 million during the first quarter of 2011 compared to \$0.9 million during the first quarter of 2010. Dividends

paid during the first quarter of 2011 were \$3.6 million, and dividends paid during the first quarter of 2010 were \$2.4 million.

Table of Contents*Contingent Convertible Senior Notes and Other Long-Term Commitments*

We have two outstanding series of Contingent Convertible Senior Notes, consisting of \$169.1 million principal amount of 2.5% Contingent Convertible Senior Notes due 2032 (the Old Notes) and \$0.2 million principal amount of 1.5% Contingent Convertible Senior Notes due 2033 (the New Notes). 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. On June 4, 2012 and 2017, or upon the occurrence of a change in control, holders of the Old Notes may require us to offer to repurchase their Old Notes for cash. On June 4, 2013 and 2018, or upon the occurrence of a change in control, holders of the New Notes may require us to offer to repurchase their New Notes for cash.

Except for the New Notes and Old Notes, we had only \$5.0 million of long-term liabilities at March 31, 2011, and we had \$378.5 million of current liabilities at March 31, 2011. 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.

Dividends

We do not have a dividend policy. Prior to July 2003, we had not paid a cash dividend on our common stock. Since July 2003, we have paid quarterly cash dividends aggregating approximately \$63.5 million on our common stock. In addition, on March 22, 2011, we announced that our Board of Directors had declared a cash dividend of \$0.08 per issued and outstanding share of common stock, which was paid on April 29, 2011, to our stockholders of record at the close of business on April 1, 2011. This represents a 33% increase compared to our previous \$0.06 dividend. 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.

Fair Value Measurements

We utilize unobservable (Level 3) inputs in determining the fair value of our auction rate floating security investments, which totaled \$20.8 million at March 31, 2011. These securities were included in long-term investments at March 31, 2011.

Our auction rate floating securities are classified as available-for-sale securities and are reflected at fair value. In prior periods, due to the auction process which took place every 30-35 days for most securities, quoted market prices were readily available, which would qualify as Level 1 under ASC 820, *Fair Value Measurements and Disclosure*. However, due to events in credit markets that began during the first quarter of 2008, the auction events for most of these instruments failed, and, therefore, we determined the estimated fair values of these securities, beginning in the first quarter of 2008, utilizing a discounted cash flow analysis. These analyses consider, among other items, the collateralization underlying the security investments, the expected future cash flows, including the final maturity, associated with the securities, and the expectation of the next time the security is expected to have a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by us. Due to these events, we reclassified these instruments as Level 3 during the first quarter of 2008.

Off-Balance Sheet Arrangements

As of March 31, 2011, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Securities and Exchange Commission (SEC) Regulation S-K.

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

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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 year ended December 31, 2010. There were no new significant accounting estimates in the first quarter of 2011, nor were there any material changes to the critical accounting policies and estimates discussed in our Form 10-K for the year ended December 31, 2010.

Items Deducted From Gross Revenue

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, inventory in the distribution channel, cash discounts, chargebacks, managed care and Medicaid rebates and consumer rebate and loyalty programs 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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The following table shows the activity of each reserve, associated with the various sales provisions that serve to reduce our accounts receivable balance or increase our accrued expenses or deferred revenue, for the three months ended March 31, 2011 and 2010 (in thousands):

| | Reserve for Sales Returns | Deferred Revenue | Sales Discounts Reserve | Chargebacks Reserve | Managed Care & Medicaid Rebates Reserve | Consumer Rebate and Loyalty Programs | Total |
|-----------------------------|--|-----------------------------|--|--------------------------------|--|---|--------------|
| Balance at Dec. 31, 2010 | \$ 60,692 | \$ 582 | \$ 2,830 | \$ 1,151 | \$ 49,375 | \$ 101,678 | \$ 216,308 |
| Actual | (12,028) | | (7,057) | (1,274) | (25,228) | (80,623) | (126,210) |
| Provision | 25,138 | 3,635 | 6,578 | 1,245 | 25,009 | 100,649 | 162,254 |
| Balance at Mar. 31, 2011 | \$ 73,802 | \$ 4,217 | \$ 2,351 | \$ 1,122 | \$ 49,156 | \$ 121,704 | \$ 252,352 |

| | Reserve for Sales Returns | Deferred Revenue | Sales Discounts Reserve | Chargebacks Reserve | Managed Care & Medicaid Rebates Reserve | Consumer Rebate and Loyalty Programs | Total |
|-----------------------------|--|-----------------------------|--|--------------------------------|--|---|--------------|
| Balance at Dec. 31, 2009 | \$ 48,062 | \$ 1,263 | \$ 2,160 | \$ 688 | \$ 47,078 | \$ 73,311 | \$ 172,562 |
| Actual | (4,553) | | (5,212) | (1,152) | (21,272) | (52,970) | (85,159) |
| Provision | 207 | 1,298 | 5,417 | 1,612 | 23,158 | 74,241 | 105,933 |
| Balance at Mar. 31, 2010 | \$ 43,716 | \$ 2,561 | \$ 2,365 | \$ 1,148 | \$ 48,964 | \$ 94,582 | \$ 193,336 |

The provision for product returns was \$25.1 million, or 7.4% of gross product sales, and \$0.2 million, or 0.1% of gross product sales, for the three months ended March 31, 2011 and 2010, respectively. The reserve for product returns increased \$13.1 million, from \$60.7 million as of December 31, 2010 to \$73.8 million as of March 31, 2011. The increase in the provision during the comparable periods and in the reserve during the three months ended March 31, 2011 was primarily related to additional estimated required reserves for newly-launched products.

The provision for cash discounts was \$6.6 million, or 1.9% of gross product sales, and \$5.4 million, or 1.7% of gross product sales, for the three months ended March 31, 2011 and 2010, respectively. The reserve for cash discounts decreased \$0.4 million, from \$2.8 million as of December 31, 2010 to \$2.4 million as of March 31, 2011. The increase in the provision during the comparable periods was due to an increase in gross product sales.

The provision for managed care and Medicaid rebates was \$25.0 million, or 7.4% of gross product sales, and \$23.2 million, or 7.5% of gross product sales, for the three months ended March 31, 2011 and 2010, respectively. The reserve for managed care and Medicaid rebates decreased \$0.2 million, from \$49.4 million as of December 31, 2010 to \$49.2 million as of March 31, 2011. The increase in the provision during the comparable periods was due to an increase in eligible gross product sales.

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The provision for consumer rebates and loyalty programs was \$100.6 million, or 29.6% of gross product sales, and \$74.2 million, or 24.0% of gross product sales, for the three months ended March 31, 2011 and 2010, respectively. The reserve for consumer rebates and loyalty programs increased \$20.0 million, from \$101.7 million as of December 31, 2010 to \$121.7 million as of March 31, 2011. The increase in the provision during the comparable periods and in the reserve during the three months ended March 31, 2011 was primarily due to the continued growth in consumer rebate programs related to our SOLODYN[®], ZIANA[®] RESTYLANE[®] and PERLANE[®] products.

Recent Accounting Pronouncements

In October 2009, the FASB approved for issuance Accounting Standards Update (ASU) No. 2009-13, *Revenue Recognition (ASC 605) Multiple Deliverable Revenue Arrangements*, a consensus of EITF 08-01, *Revenue Arrangements with Multiple Deliverables*. This guidance modifies the fair value requirements of ASC subtopic 605-25 *Revenue Recognition Multiple Element Arrangements* by providing principles for allocation of consideration among its multiple-elements, allowing more flexibility in identifying and accounting for separate deliverables under an arrangement. An estimated selling price method is introduced for valuing the elements of a bundled arrangement if vendor-specific objective evidence or third-party evidence of selling price is not available, and significantly expands related disclosure requirements. This updated guidance is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Alternatively, adoption may be on a retrospective basis, and early application is permitted. The adoption of the guidance on January 1, 2011 did not have a material impact on our results of operations and financial condition.

In March 2010, the FASB approved for issuance ASU No. 2010-17, *Revenue Recognition-Milestone Method (Topic 605): Milestone Method of Revenue Recognition*. The updated guidance recognizes the milestone method as an acceptable revenue recognition method for substantive milestones in research or development transactions, and is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. The adoption of the guidance on January 1, 2011 did not have a material impact on our results of operations and financial condition.

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 (the Exchange Act). 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, and other words and terms of similar 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:

- development and launch of new competitive products, including over-the-counter or generic competitor products;
- the ability to compete against generic and other branded products;
- increases or decreases in the expected costs to be incurred in connection with the research and development, clinical trials, regulatory approvals, commercialization and marketing of our products;

the success of research and development activities, including the development of additional forms of SOLODYN[®], and our ability to obtain regulatory approvals;

the speed with which regulatory authorizations and product launches may be achieved;

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changes in the FDA's position on the safety or effectiveness of our products;

changes in our product mix;

the anticipated size of the markets and demand for our products;

changes in prescription levels;

the impact of acquisitions, divestitures and other significant corporate transactions, including the disposition of LipoSonix;

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

manufacturing or supply interruptions;

importation of other dermal filler or botulinum toxin products, including the unauthorized distribution of products approved in countries neighboring the U.S.;

changes in the prescribing or procedural practices of dermatologists and/or plastic surgeons, including prescription levels;

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

difficulties or delays in manufacturing and packaging of our products, including delays and quality control lapses of third party manufacturers and suppliers of our products;

the availability of product supply or changes in the cost of raw materials;

trends toward managed care and health care cost containment, including health care initiatives and other third-party cost-containment pressures that could impose financial burdens or cause us to sell our products at lower prices, resulting in decreased revenues;

inadequate protection of our intellectual property or challenges to the validity or enforceability of our proprietary rights and our ability to secure patent protection from filed patent applications for our primary products, including SOLODYN®;

possible introduction of generic versions of our products, including SOLODYN®;

possible federal and/or state legislation or regulatory action affecting, among other things, the Company's ability to enter into agreements with companies introducing generic versions of the Company's products as well as pharmaceutical pricing, federal pharmaceutical contracts, mandatory discounts, and reimbursement, including under 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 (see Note 16 in our accompanying condensed consolidated financial statements and Part II, Item 1, Legal Proceedings);

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;

access to available and feasible financing on a timely basis;

the availability of product acquisition or in-licensing opportunities;

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;

the inability to obtain required regulatory approvals for any of our pipeline products;

unexpected costs and expenses, or our ability to limit costs and expenses as our business continues to grow;

decreases in revenues associated with the Company's early 2011 discontinuation of TRIAZOLAM and decision to no longer promote PLEXION®;

downturns in general economic conditions that negatively affect our dermal restorative and branded prescription products, and our ability to accurately forecast our financial performance as a result;

failure to comply with our corporate integrity agreement, which could result in substantial civil or criminal penalties and our being excluded from government health care programs, which could materially reduce our sales and adversely affect our financial condition and results of operations; and

the inability to successfully integrate newly-acquired entities.

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 year ended December 31, 2010, and this Quarterly Report contain discussions of various risks relating to our business that could cause actual results to differ materially from expected and historical results, which you should review. You should understand that it is not

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possible to predict or identify all such risks. 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 March 31, 2011, there were no material changes to the information previously reported under Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2010.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of 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 March 31, 2011, 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.

Although the management of the 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 errors 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 the 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 March 31, 2011, 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.

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Item 1. Legal Proceedings

Teva-Barr SOLODYN® Litigation

On November 20, 2009, we received a Paragraph IV Patent Certification from Barr Laboratories, Inc. (Barr), advising that Barr had filed a supplement to an earlier filed ANDA assigned ANDA number 65-485 with the FDA for generic versions of SOLODYN® in 65mg and 115mg strengths. Barr has not advised us as to the timing or status of the FDA's review of its filing, or whether Barr has complied with FDA requirements for proving bioequivalence. Barr's Paragraph IV Patent Certification alleges that our U.S. patent No. 5,908,838 (the 838 Patent) is invalid, unenforceable and/or will not be infringed by Barr's manufacture, use, sale and/or importation of the products for which the supplement was submitted. On December 28, 2009, we filed suit against Barr and Teva Pharmaceuticals USA, Inc., (collectively Teva) in the United States District Court for the District of Maryland seeking an adjudication that Teva has infringed one or more claims of the 838 Patent by submitting to the FDA the supplement to its ANDA for generic versions of SOLODYN® in 65mg and 115mg strengths. The relief we requested includes a request for a permanent injunction preventing Teva from infringing the 838 Patent by selling generic versions of SOLODYN® in 65mg and 115mg strengths. As a result of the filing of the suit, we believe that the supplement to the ANDA cannot be approved by the FDA until after the expiration of the 30-month stay period or a court decision that the patent is invalid or not infringed.

On July 9, 2010, we amended our complaint against Teva in the United States District Court for the District of Maryland relating to Barr's filing of its ANDA for generic versions of SOLODYN® in 65mg and 115mg strengths. We amended the complaint to assert new claims 19, 21, 23, 25 and 27-34 of the 838 Patent included in an Ex parte Reexamination Certificate we received from the U.S. Patent and Trademark Office (USPTO) on June 1, 2010 in connection with a reexamination of the 838 Patent by the USPTO at the request of a third party. The complaint seeks an adjudication that Barr has infringed one or more claims of the 838 Patent, including the new claims, by submitting the ANDA, and amendments or supplements thereto, to the FDA.

On October 18, 2010, we amended our complaint against Teva in the United States District Court for the District of Maryland relating to Barr's filing of its ANDA for generic versions of SOLODYN® in 65mg and 115mg strengths. We amended the complaint to allege that Teva has infringed one or more claims of our U.S. Patent No. 7,790,705 (the 705 Patent) by submitting its ANDA, and amendments or supplements thereto, to the FDA to obtain approval for the commercial manufacture, use, offer for sale, sale, or distribution in and/or importation into the United States of its generic versions of SOLODYN® before the expiration of the 705 Patent.

On February 9, 2011, we received a Paragraph IV Patent Certification from Barr advising that Barr has filed a supplement or amendment to its earlier filed ANDA with the FDA for generic versions of SOLODYN® in 55mg, 80mg and 105mg strengths. The Paragraph IV Patent Certification alleges that the 838 Patent and the 705 Patent are invalid, unenforceable and/or will not be infringed by Barr's manufacture, use, offer for sale and/or sale of the products for which the supplement or amendment was submitted. Barr's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the supplement or amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patents are invalid or not infringed.

On February 24, 2011, we entered into a Settlement Agreement (Teva Settlement Agreement) with Teva. Under the terms of the Teva Settlement Agreement, we agreed to grant to Teva a future license to make and sell our generic versions of SOLODYN® in 65mg and 115mg strengths under the SOLODYN® intellectual property rights belonging to us, with the license grant effective in February 2018, or earlier under certain conditions. We also agreed to grant to Teva a future license to make and sell generic versions of SOLODYN® in 55mg, 80mg and 105mg strengths under our SOLODYN® intellectual property rights, with the license grant effective in February 2019, or earlier under certain conditions. The Teva Settlement Agreement provides that Teva will be required to pay us royalties based on sales of Teva's generic SOLODYN® products pursuant to the foregoing licenses.

Pursuant to the Teva Settlement Agreement, the companies agreed to terminate all legal disputes between them relating to SOLODYN®. In addition, Teva confirmed that our patents relating to SOLODYN® are valid and enforceable, and cover Teva's activities relating to Teva's generic SOLODYN® products under ANDA No. 65-485 and any amendments and supplements thereto. Teva also agreed to be permanently enjoined from any distribution

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of generic SOLODYN® products in the U.S. except as described above. The United States District Court for the District of Maryland subsequently entered a permanent injunction against any infringement by Teva.

Lupin SOLODYN® Litigation

On October 8, 2009, we received a Paragraph IV Patent Certification from Lupin Ltd. (Lupin) advising that Lupin had filed an ANDA with the FDA for generic versions of SOLODYN® in 45mg, 90mg, and 135mg strengths. Lupin did not advise us as to the timing or status of the FDA's review of its filing, or whether it has complied with FDA requirements for proving bioequivalence. Lupin's Paragraph IV Patent Certification alleges that our 838 Patent is invalid. Lupin's Paragraph IV Patent Certification also alleges that our U.S. Patent Nos. 7,541,347, (the 347 Patent) and 7,544,373 (the 373 Patent) are not infringed by Lupin's manufacture, importation, use, sale and/or offer for sale of the products for which its ANDA was submitted. On November 17, 2009, we filed suit against Lupin in the United States District Court for the District of Maryland seeking an adjudication that Lupin has infringed one or more claims of the 838 Patent by submitting to the FDA its ANDA for generic versions of SOLODYN® in 45mg, 90mg and 135mg strengths. The relief we requested includes a request for a permanent injunction preventing Lupin from infringing the 838 Patent by selling generic versions of SOLODYN®. As a result of the filing of the suit, we believe that the ANDA cannot be approved by the FDA until after the expiration of a 30-month stay period or a court decision that the patent is invalid or not infringed.

On November 24, 2009, we received a Paragraph IV Patent Certification from Lupin, advising that Lupin had filed a supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 with the FDA for a generic version of SOLODYN® in 65mg strength. Lupin has not advised us as to the timing or status of the FDA's review of its filing, or whether Lupin has complied with FDA requirements for proving bioequivalence. Lupin's Paragraph IV Patent Certification alleges that our 838 Patent is invalid. Lupin's Paragraph IV Patent Certification also alleges that our 347 Patent or 373 Patent is not infringed by Lupin's manufacture, importation, use, sale and/or offer for sale of the products for which the supplement or amendment was submitted. Lupin's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the supplement or amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patent is invalid or not infringed.

On December 23, 2009, we received a Paragraph IV Patent Certification from Lupin advising that Lupin had filed a supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 with the FDA for a generic version of SOLODYN® in 115mg strength. Lupin has not advised us as to the timing or status of the FDA's review of its filing, or whether Lupin has complied with FDA requirements for proving bioequivalence. Lupin's Paragraph IV Patent Certification alleges that the 838 Patent is invalid. Lupin's Paragraph IV Patent Certification also alleges that the 347 Patent and 373 Patent are not infringed by Lupin's manufacture, importation, use, sale and/or offer for sale of the products for which the supplement or amendment was submitted. Lupin's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the supplement or amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patent is invalid or not infringed. On December 28, 2009, we amended our complaint against Lupin seeking an adjudication that Lupin has infringed one or more claims of the 838 Patent by submitting its supplement or amendment to its ANDA for a generic version of SOLODYN® in 65mg strength. On February 2, 2010, we amended our complaint against Lupin seeking an adjudication that Lupin has infringed one or more claims of the 838 Patent by submitting its supplement or amendment to its earlier filed ANDA for a generic version of SOLODYN® in 115mg strength.

On July 1, 2010, we amended our complaint against Lupin in the United States District Court for the District of Maryland relating to Lupin's filing of its ANDA, and amendments or supplements thereto, for generic versions of SOLODYN® in 45mg, 65mg, 90mg, 115mg and 135mg strengths. We amended the complaint to assert new claims 19, 21, 23, 25 and 27-34 of the 838 Patent included in an Ex Parte Reexamination Certificate we received from the USPTO on June 1, 2010 in connection with a reexamination of the 838 Patent by the USPTO at the request of a third party. The complaint seeks an adjudication that Lupin has infringed one or more claims of the 838 Patent, including the new claims, by submitting the ANDA, and amendments or supplements thereto, to the FDA.

On September 17, 2010, we received an additional Paragraph IV Patent Certification from Lupin advising that Lupin had filed a supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 with the FDA for generic versions of SOLODYN® in 45mg, 65mg, 90mg, 115mg and 135mg strengths. Lupin's Paragraph IV Patent

Certification alleges that the 705 Patent, which was issued to us by the USPTO on September 7, 2010,

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will not be infringed by Lupin's manufacture, use, sale and/or importation of the products for which the supplement or amendment was submitted. Lupin's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the supplement or amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patent is invalid or not infringed.

On October 18, 2010, we amended our complaint against Lupin in the United States District Court for the District of Maryland relating to Lupin's filing of its ANDA, and amendments or supplements thereto for generic versions of SOLODYN® in 45mg, 65mg, 90mg, 115mg and 135mg strengths. We amended the complaint to allege that Lupin has infringed one or more claims of the '705 Patent by submitting its ANDA, and amendments or supplements thereto, to the FDA to obtain approval for the commercial manufacture, use, offer for sale, sale, or distribution in and/or importation into the United States of its generic versions of SOLODYN® before the expiration of the '705 Patent.

On December 3, 2010, we received a Paragraph IV Patent Certification from Lupin advising that Lupin had filed a supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 with the FDA for generic versions of SOLODYN® in 55mg and 80mg strengths. Lupin has not advised us as to the timing or status of the FDA's review of its filing, or whether Lupin has complied with FDA requirements for proving bioequivalence. Lupin's Paragraph IV Patent Certification alleges that the '838 Patent is invalid. Lupin's Paragraph IV Patent Certification also alleges that the '705 Patent will not be infringed by Lupin's manufacture, use, sale and/or importation of the products for which the supplement or amendment was submitted. Lupin's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the supplement or amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patents are invalid or not infringed. On January 10, 2011, we amended our complaint against Lupin seeking an adjudication that Lupin has infringed one or more claims of the '838 Patent and the '705 Patent by filing the supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 for generic versions of SOLODYN® in 55mg and 80mg strengths.

On January 24, 2011, we received a Paragraph IV Patent Certification from Lupin advising that Lupin had filed a supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 with the FDA for a generic version of SOLODYN® in 105mg strength. Lupin has not advised us as to the timing or status of the FDA's review of its filing, or whether Lupin has complied with FDA requirements for proving bioequivalence. Lupin's Paragraph IV Patent Certification alleges that the '838 Patent is invalid. Lupin's Paragraph IV Patent Certification also alleges that the '705 Patent will not be infringed by Lupin's manufacture, use, sale and/or importation of the products for which the supplement or amendment was submitted. Lupin's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the supplement or amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patents are invalid or not infringed. On March 2, 2011, we amended our complaint against Lupin seeking an adjudication that Lupin has infringed one or more claims of the '838 Patent and the '705 Patent by filing the supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 for generic versions of SOLODYN® in 105mg strength.

On February 2, 2011, the Maryland Court issued an Order staying the litigation through and including April 1, 2011, to permit us and Lupin to discuss settlement of the litigation. On March 24, 2011, we and Lupin jointly requested that the Court extend the stay for an additional period through and including May 16, 2011, which was subsequently approved by the Court.

On April 19, 2011, we received a Paragraph IV Patent Certification from Lupin advising that Lupin had filed a supplement or amendment to its earlier filed ANDA assigned ANDA number 91-424 with the FDA for generic versions of SOLODYN® in 45mg, 55mg, 65mg, 80mg, 90mg, 105mg, 115mg and 135 mg strengths. Lupin has not advised us as to the timing or status of the FDA's review of its filing, or whether Lupin has complied with FDA requirements for proving bioequivalence. Lupin's Paragraph IV Patent Certification alleges that the Company's newly issued U.S. Patent No. 7,919,483 (the '483 Patent), which was issued to the Company by the USPTO on April 5, 2011, will not be infringed by Lupin's manufacture, use, sale and/or importation of the products for which the supplement or amendment was submitted. The expiration date for the '483 Patent is in February 2027. We are evaluating the details of Lupin's certification letter and considering our options. Lupin's submission amends an ANDA already subject to a 30-month stay. As such, we believe that the amendment cannot be approved by the FDA until after the expiration of the 30-month period or a court decision that the patent is invalid or not infringed.

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On October 26, 2010, we received a Paragraph IV Patent Certification from Aurobindo Pharma Limited (Aurobindo Pharma) advising that Aurobindo Pharma had filed an ANDA with the FDA for generic versions of SOLODYN® in 45mg, 65mg, 90mg, 115mg and 135mg strengths. Aurobindo Pharma has not advised us as to the timing or status of the FDA's review of its filing, or whether it has complied with FDA requirements for proving bioequivalence. Aurobindo Pharma's Paragraph IV Patent Certification alleges that the 838 Patent is invalid. Aurobindo Pharma's Paragraph IV Patent Certification also alleges that the 347 Patent, 373 Patent and 705 Patent are not infringed by Aurobindo Pharma's manufacture, importation, use, sale and/or offer for sale of the products for which the ANDA was submitted.

On December 3, 2010, we filed suit against Aurobindo Pharma and Aurobindo Pharma USA, Inc. (together, Aurobindo) in the United States District Court for the District of Delaware. On December 6, 2010, we also filed suit against Aurobindo in the United States District Court for the District of New Jersey. The suits seek an adjudication that Aurobindo has infringed one or more claims of the 838 Patent and the 705 Patent by submitting to the FDA an ANDA for generic versions of SOLODYN® in 45mg, 65mg, 90mg, 115mg and 135mg strengths. The relief we requested includes a request for a permanent injunction preventing Aurobindo from infringing the asserted claims of the 838 Patent and the 705 Patent by engaging in the manufacture, use, importation, offer to sell, sale or distribution of generic versions of SOLODYN® before the expiration of the patents.

Nycomed VANOS® Litigation

On April 7, 2010, we received a Paragraph IV Patent Certification from Nycomed US Inc. advising that Nycomed US Inc. had filed an ANDA with the FDA for a generic version of VANOS®. Nycomed US Inc. has not advised us as to the timing or status of the FDA's review of its filing, or whether it has complied with FDA requirements for proving bioequivalence. Nycomed US Inc.'s Paragraph IV Patent Certification alleges that our U.S. Patent Nos. 6,765,001 (the 001 Patent) and 7,220,424 (the 424 Patent) will not be infringed by Nycomed US Inc.'s manufacture, use, sale, offer for sale or importation of the product for which the ANDA was submitted.

On May 19, 2010, we filed suit against Nycomed US Inc. and Nycomed GmbH (together, Nycomed) in the United States District Court for the Southern District of New York and the United States District Court for the District of Delaware seeking an adjudication that Nycomed has infringed one or more claims of our 001 Patent, 424 Patent and U.S. Patent No. 7,217,422 (the 422 Patent) by submitting the ANDA to the FDA. The relief we requested includes a request for a permanent injunction preventing Nycomed from infringing the patents by selling a generic version of VANOS® prior to the expiration of the asserted patents. On August 3, 2010, Nycomed responded in the New York action by filing an answer, affirmative defenses, and counterclaims alleging that the patents-in-suit are invalid, unenforceable, and will not be infringed by Nycomed's proposed generic version of VANOS®, and a motion to dismiss certain claims related to the patents-in-suit. On August 3, 2010, Nycomed responded in the Delaware action by filing a motion to transfer the Delaware action to New York and a motion to dismiss certain claims related to the patents-in-suit. We responded to Nycomed's motions and pleadings on December 15, 2010.

On December 23, 2010, Nycomed filed an amended answer and counterclaims in the New York action alleging only invalidity and noninfringement of the patents-in-suit. On January 14, 2011, we filed an answer to Nycomed's amended counterclaims in the New York action denying that any of the asserted patents are invalid or not infringed. On January 19, 2011 and January 24, 2011, the New York court endorsed the parties' stipulations withdrawing all pending motions. On March 11, 2011, the New York court held a case management conference and informed the parties that the case was being reassigned. A new scheduling conference has been set for May 20, 2011.

On January 19, 2011, the Delaware court endorsed the parties' stipulation withdrawing Nycomed's pending motion to dismiss and ordering Nycomed to answer or otherwise respond to the complaint. On February 2, 2011, Nycomed filed an answer with affirmative defenses alleging that the patents are invalid, unenforceable, and will not be infringed by Nycomed's proposed generic version of VANOS®. On March 31, 2011, the Delaware Court granted Nycomed's motion to transfer the Delaware action to New York.

On December 15, 2010, we filed a new complaint for patent infringement against Nycomed US Inc. in the United States District Court for the District of Delaware. Our new complaint seeks an adjudication that Nycomed US's filing of its ANDA for fluocinonide cream 0.1% infringes one or more claims of our U.S. Patent No. 7,794,738

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(the 738 Patent). On February 15, 2011, Nycomed responded by filing a motion to transfer the new Delaware action to New York, as well as a motion to dismiss for failure to state a claim and lack of subject matter jurisdiction. Medicis opposed both motions on March 4, 2011, and Nycomed replied on April 12, 2011. Nycomed's motions are currently pending.

Stiefel VELTIN® Litigation

On July 28, 2010, we filed suit against Stiefel Laboratories, Inc., a subsidiary of GlaxoSmithKline plc (Stiefel), in the United States District Court for the Western District of Texas – San Antonio Division seeking a declaratory judgment that the manufacture and sale of Stiefel's acne product VELTIN® Gel, which was approved by the FDA in 2010, will infringe one or more claims of our U.S. Patent No. RE41,134 (the 134 Patent) covering our product ZIANA® Gel, a prescription topical gel indicated for the treatment of acne that was approved by the FDA in November 2006. The 134 Patent is listed in the FDA's *Approved Drug Products with Therapeutic Equivalence Evaluations* (Orange Book) and expires in February 2015. We have rights to the 134 Patent pursuant to an exclusive license agreement with the owner of the patent. The relief we requested in the lawsuit includes a request for a permanent injunction preventing Stiefel from infringing the 134 Patent by engaging in the commercial manufacture, use, importation, offer to sell, or sale of any therapeutic composition or method of use covered by the 134 Patent, including such activities relating to VELTIN®, and from inducing or contributing to any such activities. On October 8, 2010, we and the owner of the 134 Patent filed a motion for a Preliminary Injunction seeking to enjoin sales of VELTIN®. The motion for Preliminary Injunction remains pending.

Actavis ZIANA® Litigation

On March 30, 2011, we received a Paragraph IV Patent Certification from Actavis Mid Atlantic LLC (Actavis) advising that Actavis has filed an ANDA with the FDA for a generic version of ZIANA® (clindamycin phosphate 1.2% and tretinoin 0.025%) Gel. Actavis has not advised us as to the timing or status of the FDA's review of its filing, or whether Actavis has complied with FDA requirements for proving bioequivalence. Actavis' Paragraph IV Patent Certification alleges that the Company's U.S. Patent Nos. RE41,134 (the 134 Patent) and 6,387,383 (the 383 Patent) will not be infringed by Actavis' manufacture, use and/or sale of the product for which the ANDA was submitted. The expiration date for the 134 Patent is in 2015, and the expiration date for the 383 Patent is in 2020. We are currently evaluating the details of Actavis' certification letter and considering our options.

Acella TRIAZ® Litigation

On August 19, 2010, we filed suit against Acella Pharmaceuticals, Inc. (Acella) in the United States District Court for the District of Arizona based on Acella's manufacture and offer for sale of benzoyl peroxide foaming cloths which we believe infringe one or more claims of our U.S. Patent No. 7,776,355 (the 355 Patent) covering certain of our products, including TRIAZ® (benzoyl peroxide) 3%, 6% and 9% Foaming Cloths indicated for the topical treatment of acne vulgaris. The 355 Patent was issued to us by the USPTO on August 17, 2010 and expires in June 2026. The relief we requested in the lawsuit includes a request for a Permanent Injunction preventing Acella from infringing the 355 Patent by engaging in the manufacture, use, importation, offer to sell, or sale of any products covered by the 355 Patent, including Acella's benzoyl peroxide foaming cloths, and from inducing or contributing to any such activities. Acella filed with the USPTO a request for ex parte reexamination of the 355 Patent, and filed with the Court a request that the litigation be stayed for the duration of the reexamination. Both the request for reexamination and the request for a stay were initially denied. Acella resubmitted its request for reexamination to the USPTO, which was granted on December 15, 2010. Acella again requested that the case be stayed pending reexamination, and the Court again denied Acella's request. We filed a motion for a Preliminary Injunction on December 10, 2010. The hearing on the Preliminary Injunction motion was to be combined with a Markman Hearing that was also scheduled for February 23, 2011. At a Markman Hearing, a court determines the scope of the patent's claims. The Court held only the Markman Hearing on February 23, 2011, and deferred the hearing on the Preliminary Injunction motion until March 29, 2011. At the Markman Hearing, the Court determined the scope of the patent's claims. Due to the need to postpone the March 29, 2011 hearing on the Preliminary Injunction due to scheduled conflicts, we withdrew our motion for a Preliminary Injunction in favor of a motion for an expedited trial. The case is now set for trial in January 2012.

The information set forth under Legal Matters in Note 16 in the notes to the condensed consolidated financial statements, included in Part I, Item I of this Report, is incorporated herein by reference. The pending

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proceedings described in this section and in **Legal Matters** in Note 16 in the notes to the condensed consolidated financial statements included in Part I, Item I of this Report involve complex questions of fact and law and will require the expenditure of significant funds and the diversion of other resources to prosecute and defend. The results of legal proceedings are inherently uncertain, and material adverse outcomes are possible. The resolution of intellectual property litigation may require us to pay damages for past infringement or to obtain a license under the other party's intellectual property rights that could require one-time license fees or ongoing royalties, which could adversely impact our product gross margins in future periods, or could prevent us from manufacturing or selling some of our products or limit or restrict the type of work that employees involved in such litigation may perform for us. From time to time we may enter into confidential discussions regarding the potential settlement of pending litigation or other proceedings; however, there can be no assurance that any such discussions will occur or will result in a settlement. The settlement of any pending litigation or other proceeding could require us to incur substantial settlement payments and costs. In addition, the settlement of any intellectual property proceeding may require us to grant a license to certain of our intellectual property rights to the other party under a cross-license agreement. If any of those events were to occur, our business, financial condition and results of operations could be materially and adversely affected.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves a number of risks that could materially and adversely affect our business, financial condition, prospects, operating results or cash flows. For a detailed discussion of the risk factors that should be understood by any investor contemplating investment in our stock, please refer to Part I, **Item 1A Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2010.

There are no material changes from the risk factors previously disclosed in Part I, **Item 1A Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2010.

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Item 6. Exhibits

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|-----------------|--|
| Exhibit 10.1+* | Settlement Agreement, dated as of February 24, 2011, between the Company and Barr Laboratories, Inc. (a wholly owned subsidiary of Teva Pharmaceuticals USA, Inc.) |
| 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 |
| Exhibit 101++** | The following financial information from Medicis Pharmaceutical Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, formatted in XBRL (Extensible Business Reporting Language) includes: (i) the Condensed Consolidated Balance Sheets as of March 31, 2011 and December 31, 2010, (ii) the Condensed Consolidated Statements of Income for each of the three-month periods ended March 31, 2011 and 2010, (iii) the Condensed Consolidated Statements of Cash Flows for each of the three-month periods ended March 31, 2011 and 2010, and (iv) the Notes to the Condensed Consolidated Financial Statements. |

+ Filed herewith

++ Furnished herewith

* Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment pursuant to Rule 24b-2 under the Securities Exchange Act of 1934.

** Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

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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: May 10, 2011

By: /s/ Jonah Shacknai
Jonah Shacknai
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

Date: May 10, 2011

By: /s/ Richard D. Peterson
Richard D. Peterson
Executive Vice President,
Chief Financial Officer and Treasurer
(Principal Financial and Accounting
Officer)