

MEDICIS PHARMACEUTICAL CORP

Form 10-Q/A

November 10, 2008

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

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

For the quarterly period ended March 31, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 0-18443

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware

52-1574808

(State or other jurisdiction of
incorporation or organization)

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

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

Large accelerated filer ☒ 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.

Class

Outstanding at November 3, 2008

Class A Common Stock \$.014 Par Value

56,717,496

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EXPLANATORY NOTE

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

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

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

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

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

In connection with the restatement, management has assessed the effectiveness of our disclosure controls and procedures and has included revised disclosure in this Form 10-Q/A under Item 4 of Part I, Controls and Procedures. Management identified a material weakness in our internal control over financial reporting with respect to our

interpretation and application of SFAS 48 as it applies to the calculation of sales return reserves, as described in our Form 10-K/A for the year ended December 31, 2007, under Item 9 of Part II in Management's Report on Internal Control over Financial Reporting. Solely as a result of this material weakness, our Chief

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

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

Because this Form 10-Q/A sets forth the 2008 First Quarter Form 10-Q in its entirety, it includes items that have been changed as a result of the restatement and items that are unchanged from the 2008 First Quarter Form 10-Q. Other than the amending of the disclosures relating to the restatement, this Form 10-Q/A speaks as of the original filing date of the 2008 First Quarter 10-Q and has not been updated to reflect other events occurring subsequent to the original filing date. This includes forward-looking statements, Risk Factors, and all other sections of this Form 10-Q/A that were not directly impacted by the restatement, which should be read in their historical context. This Form 10-Q/A should be read in conjunction with our Form 10-K/A for the year ended December 31, 2007, our Form 10-Q/A for the quarter ended June 30, 2008, and our Form 10-Q for the quarter ended September 30, 2008.

Note 2 to our restated condensed consolidated financial statements discloses the nature of the restatement adjustments and details the impact of the restatement adjustments on our condensed consolidated financial statements as of March 31, 2008 and the three months ended March 31, 2008 and 2007.

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

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

	March 31, 2008 (Restated) (unaudited)	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 201,648	\$ 108,046
Short-term investments	578,502	686,634
Accounts receivable, net	33,970	22,205
Inventories, net	26,696	29,973
Deferred tax assets, net	6,399	9,190
Other current assets	24,547	18,049
Total current assets	871,762	874,097
Property and equipment, net	23,097	13,850
Intangible assets:		
Intangible assets related to product line acquisitions and business combinations	258,873	258,873
Other intangible assets	6,728	6,695
	265,601	265,568
Less: accumulated amortization	97,824	92,482
Net intangible assets	167,777	173,086
Goodwill	63,107	63,107
Deferred tax assets, net	57,371	59,577
Long-term investments	61,747	17,072
Other assets	9,466	12,622
	\$ 1,254,327	\$ 1,213,411

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, 2008 (Restated) (unaudited)	December 31, 2007
Liabilities		
Current liabilities:		
Accounts payable	\$ 52,753	\$ 34,891
Current portion of contingent convertible senior notes	283,910	283,910
Reserve for sales returns	68,098	68,787
Income taxes payable	6,079	7,731
Other current liabilities	52,006	55,807
 Total current liabilities	 462,846	 451,126
 Long-term liabilities:		
Contingent convertible senior notes	169,145	169,145
Deferred revenue	6,042	6,667
Other liabilities	9,097	3,172
 Stockholders' Equity		
Preferred stock, \$0.01 par value; shares authorized: 5,000,000; no shares issued		
Class A common stock, \$0.014 par value; shares authorized: 150,000,000; issued and outstanding: 69,079,186 and 69,005,019 at March 31, 2008 and December 31, 2007, respectively	965	965
Class B common stock, \$0.014 par value; shares authorized: 1,000,000; issued and outstanding: none		
Additional paid-in capital	646,708	641,907
Accumulated other comprehensive income	3,236	2,221
Accumulated earnings	299,455	281,218
Less: Treasury stock, 12,668,092 and 12,656,503 shares at cost at March 31, 2008 and December 31, 2007, respectively	(343,167)	(343,010)
 Total stockholders' equity	 607,197	 583,301
	\$ 1,254,327	\$ 1,213,411

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	March 31, 2008 (Restated)	March 31, 2007 (Restated)
Net product revenues	\$ 125,054	\$ 95,922
Net contract revenues	3,849	2,743
Net revenues	128,903	98,665
Cost of product revenues (1)	11,132	11,562
Gross profit	117,771	87,103
Operating expenses:		
Selling, general and administrative (2)	72,062	61,195
Research and development (3)	9,189	8,006
Depreciation and amortization	6,722	5,455
Operating income	29,798	12,447
Other expense	2,871	
Interest and investment income	(9,199)	(9,007)
Interest expense	2,407	2,658
Income before income tax expense	33,719	18,796
Income tax expense	13,194	7,115
Net income	\$ 20,525	\$ 11,681
Basic net income per share	\$ 0.36	\$ 0.21
Diluted net income per share	\$ 0.31	\$ 0.19
Cash dividend declared per common share	\$ 0.04	\$ 0.03

Basic common shares outstanding	56,358	55,626
Diluted common shares outstanding	70,332	71,720

(1) amounts exclude amortization of intangible assets related to acquired products	\$ 5,286	\$ 4,798
(2) amounts include share-based compensation expense	\$ 4,329	\$ 5,377
(3) amounts include share-based compensation expense	\$ 61	\$ 138

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, 2008 (Restated)	March 31, 2007 (Restated)
Operating Activities:		
Net income (restated)	\$ 20,525	\$ 11,681
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,722	5,455
Amortization of deferred financing fees	285	536
Loss on disposal of property and equipment		19
Charge reducing value of investment in Revance	2,871	
Gain on sale of available-for-sale investments	(117)	(23)
Share-based compensation expense	4,390	5,515
Deferred income tax expense	4,997	8,118
Tax (expense) benefit from exercise of stock options and vesting of restricted stock awards	(354)	1,602
Excess tax benefits from share-based payment arrangements	(10)	(849)
Increase (decrease) in provision for sales discounts and chargebacks	2,694	(917)
Amortization of (discount)/premium on investments	(773)	(685)
Changes in operating assets and liabilities:		
Accounts receivable	(14,459)	25,117
Inventories	3,277	(3,826)
Other current assets	(6,497)	(6,825)
Accounts payable	17,863	3,883
Reserve for sales returns	(689)	(8,433)
Income taxes payable	(1,651)	(12,157)
Other current liabilities	(5,083)	(2,457)
Other liabilities	(888)	
Net cash provided by operating activities	33,103	25,754
Investing Activities:		
Purchase of property and equipment	(3,898)	(1,520)
Payment for purchase of product rights	(33)	(419)
Purchase of available-for-sale investments	(247,967)	(305,252)
Sale of available-for-sale investments	151,451	68,036
Maturity of available-for-sale investments	161,975	85,223
Net cash provided by (used in) investing activities	61,528	(153,932)
Financing Activities:		
Payment of dividends	(1,707)	(1,670)
Excess tax benefits from share-based payment arrangements	10	849

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Proceeds from the exercise of stock options	765	9,613
Net cash (used in) provided by financing activities	(932)	8,792
Effect of exchange rate on cash and cash equivalents	(97)	(34)
Net increase (decrease) in cash and cash equivalents	93,602	(119,420)
Cash and cash equivalents at beginning of period	108,046	203,319
Cash and cash equivalents at end of period	\$ 201,648	\$ 83,899

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2008
(unaudited)

1. NATURE OF BUSINESS

Medicis Pharmaceutical Corporation (Medicis or the Company) is a leading specialty pharmaceutical company focusing primarily on the development and marketing of products in the United States (U.S.) for the treatment of dermatological, aesthetic and podiatric conditions. Medicis also markets products in Canada for the treatment of dermatological and aesthetic conditions.

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

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

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

2. RESTATEMENT OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company has restated its condensed consolidated financial statements as of March 31, 2008 and for the three months ended March 31, 2008 and 2007. The restatement primarily relates to an error in the Company's interpretation and application of Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48) as it applies to a component of the Company's sales return reserve calculations. Management commenced a review and analysis of its accounting for sales return reserves after the Public Company Accounting Oversight Board's (the PCAOB) inspection of the Company's independent public accounting firm's, Ernst & Young LLP's, audit of the Company's 2007 financial statements. Based on the PCAOB inspection, Ernst & Young LLP informed management that the method of accounting for returns of short-dated and expired goods in the periods covered by the financial statements was not in conformity with generally accepted accounting principles, as the returns for expired product did not qualify for warranty or exchange accounting and, accordingly, under SFAS 48, the Company should have deferred the full sales price of the product for the amount of estimated returns. Management conducted a review of whether the reserve complied with SFAS 48 and whether the amounts involved were material under Staff Accounting Bulletin No. 99, *Materiality* (SAB 99), and Staff Accounting Bulletin No. 108, *Considering Effects of Prior Misstatements When Quantifying Misstatements in Current Year Financial Statements* (SAB 108), for one or more periods. Management determined that there was an error in its interpretation and application of SFAS 48 and that the adjustments necessary to properly state the sales returns reserve were material for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008. Accordingly, management recommended to the Audit Committee that a restatement was required.

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

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

The following is a summary of the effects of the restatement on the Company's condensed consolidated balance sheet as of March 31, 2008 and its condensed consolidated statements of operations and consolidated statements of cash flows for the three months ended March 31, 2008 and 2007:

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	As Previously Reported	Restatement Adjustments	As Restated
Assets			
Current assets:			
Cash and cash equivalents	\$ 201,648		\$ 201,648
Short-term investments	578,502		578,502
Accounts receivable, net	26,963	7,007	33,970
Inventories, net	26,696		26,696
Deferred tax assets, net		6,399	6,399
Other current assets	24,547		24,547
Total current assets	858,356	13,406	871,762
Property and equipment, net	23,097		23,097
Intangible assets:			
Intangible assets related to product line acquisitions and business combinations	258,873		258,873
Other intangible assets	7,096	(368)	6,728
	265,969	(368)	265,601
Less: accumulated amortization	97,824		97,824
Net intangible assets	168,145	(368)	167,777
Goodwill	63,107		63,107
Deferred tax assets, net	57,239	132	57,371
Long-term investments	61,747		61,747
Other assets	9,466		9,466
	\$ 1,241,157	\$ 13,170	\$ 1,254,327
Liabilities			
Current liabilities:			
Accounts payable	\$ 52,753		\$ 52,753
Current portion of contingent convertible senior notes	283,910		283,910
Reserve for sales returns		68,098	68,098
Income taxes payable	6,111	(32)	6,079
Deferred tax liabilities, net	15,351	(15,351)	
Other current liabilities	52,678	(672)	52,006
	410,803	52,043	462,846
Long-term liabilities:			
Contingent convertible senior notes	169,145		169,145
Deferred revenue	6,042		6,042

Other liabilities	7,787	1,310	9,097
Commitments and Contingencies			
Stockholders' Equity			
Preferred stock, \$0.01 par value; shares authorized: 5,000,000 no shares issued			
Class A common stock, \$0.014 par value, shares authorized: 150,000,000; issued and outstanding: 69,079,186	965		965
Class B common stock, \$0.014 par value, shares authorized: 1,000,000; issued and outstanding: none			
Additional paid-in capital	646,708		646,708
Accumulated other comprehensive income	3,236		3,236
Accumulated earnings	339,638	(40,183)	299,455
Less: Treasury stock, 12,668,092 shares at cost	(343,167)		(343,167)
Total stockholders' equity	647,380	(40,183)	607,197
	\$ 1,241,157	\$ 13,170	\$ 1,254,327

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CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
For the Three Months Ended March 31, 2008
(in thousands, except per share data)

	As Previously Reported	Restatement Adjustments	As Restated
Net product revenues	\$ 127,457	\$ (2,403)	\$ 125,054
Net contract revenues	3,849		