MEDICIS PHARMACEUTICAL CORP
Form 10-Q
May 12, 2008

Table of Contents

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

þ **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

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

For the transition period from_____ to_____

Commission file number: 0-18443

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of Registrant as specified in its charter)

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

8125 North Hayden Road
Scottsdale, Arizona 85258-2463
(Address of principal executive offices)
(602) 808-8800
(Registrant s telephone number, including area code)

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

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(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 o NO þ

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

Class	Outstanding at May 7, 2008
Class A Common Stock $.014 Par Value	56,437,170

MEDICIS PHARMACEUTICAL CORPORATION
Table of Contents

Table of Contents

Part I. Financial Information
Item 1. Financial Statements

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

	March 31, 2008 (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	26,963	12,377
Inventories, net	26,696	29,973
Other current assets	24,547	18,049
Total current assets	858,356	855,079
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	7,096	7,063
	265,969	265,936
Less: accumulated amortization	97,824	92,482
Net intangible assets	168,145	173,454
Goodwill	63,107	63,107
Deferred tax assets, net	57,239	59,445
Long-term investments	61,747	17,072
Other assets	9,466	12,622
	$ 1,241,157	$ 1,194,629

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	March 31, 2008 (unaudited)	December 31, 2007
Liabilities		
Current liabilities:		
Accounts payable	$ 52,753	$ 34,891
Current portion of contingent convertible senior notes	283,910	283,910
Income taxes payable	6,111	7,734
Deferred tax liabilities, net	15,351	11,684
Other current liabilities	52,678	56,781
Total current liabilities	410,803	395,000
Long-term liabilities:		
Contingent convertible senior notes	169,145	169,145
Deferred revenue	6,042	6,667
Other liabilities	7,787	1,862
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	339,638	319,872
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	647,380	621,955
	$ 1,241,157	$ 1,194,629

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended	
	March 31, 2008	March 31, 2007
Net product revenues	$ 127,457	$ 92,371
Net contract revenues	3,849	2,743
Net revenues	131,306	95,114
Cost of product revenues (1)	11,101	10,497
Gross profit	120,205	84,617
Operating expenses:		
Selling, general and administrative (2)	72,062	62,260
Research and development (3)	9,189	8,006
Depreciation and amortization	6,722	5,455
Operating income	32,232	8,896
Other expense	2,871	
Interest and investment income	(9,199)	(9,007)
Interest expense	2,407	2,658
Income before income tax expense	36,153	15,245
Income tax expense	14,099	5,957
Net income	$ 22,054	$ 9,288
Basic net income per share	$ 0.39	$ 0.17
Diluted net income per share	$ 0.34	$ 0.15
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.

Table of Contents

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

	Three Months Ended	
	March 31, 2008	March 31, 2007
Operating Activities:		
Net income	$ 22,054	$ 9,288
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	5,873	6,921
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)
Decrease in provision for doubtful accounts and returns	(127)	(6,744)
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
Income taxes payable	(1,622)	(12,118)
Other current liabilities	(5,385)	(1,512)
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
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.

Table of Contents

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 Annual Report on Form 10-K 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 should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

2. SHARE-BASED COMPENSATION

At March 31, 2008, 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 granted from these plans 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. Effective July 1, 2005, the Company adopted SFAS No. 123R using the modified prospective method. Other than restricted stock, no share-based employee compensation cost has been reflected in net income prior to the adoption of SFAS No. 123R.

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, 2008, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to March 31, 2008, was approximately $13.5 million and the related weighted-average period over which it is expected to be recognized is approximately 1.6 years.

Table of Contents

A summary of stock options activity within the Company s stock-based compensation plans and changes for the three months ended March 31, 2008 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2007	11,666,955	$27.99		
Granted	22,702	$19.60		
Exercised	(15,760)	$16.52		
Terminated/expired	(78,450)	$31.66		
Balance at March 31, 2008	11,595,447	$27.96	4.4	$8,656,396

The intrinsic value of options exercised during the three months ended March 31, 2008 was $124,731. Options exercisable under the Company s share-based compensation plans at March 31, 2008 were 9,310,046, with a weighted average exercise price of $26.38, a weighted average remaining contractual term of 4.0 years, and an aggregate intrinsic value of $8,654,353.

A summary of fully vested stock options and stock options expected to vest, based on historical forfeiture rates, as of March 31, 2008, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding	10,680,793	$28.17	4.5	$7,332,403
Exercisable	8,504,022	$26.58	4.1	$7,330,533

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, 2008	Three Months Ended March 31, 2007
Expected dividend yield	0.6%	0.4%
Expected stock price volatility	0.38	0.35
Risk-free interest rate	3.0%	4.5%
Expected life of options	7 Years	7 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, 2008 and 2007 was $8.19 and $14.59, respectively.

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company s Class A common stock on the date of grant, and the total value of the award is

expensed ratably over the service period of the employees receiving the grants. During the three months ended March 31, 2008, 346,346 shares of restricted stock were granted to certain employees.

Table of Contents

Share-based compensation expense related to all restricted stock awards outstanding during the three months ended March 31, 2008 and 2007, was approximately $1.1 million and $0.7 million, respectively. As of March 31, 2008, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to March 31, 2008, was approximately $18.5 million, and the related weighted-average period over which it is expected to be recognized is approximately 4.0 years.

A summary of restricted stock activity within the Company s share-based compensation plans and changes for the three months ended March 31, 2008 is as follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2007	552,769	$31.92
Granted	346,346	$19.60
Vested	(68,246)	$31.37
Forfeited	(2,187)	$31.91
Nonvested at March 31, 2008	828,682	$26.82

The total fair value of restricted shares vested during the three months ended March 31, 2008 and 2007 was approximately $2.1 million and $0.5 million, respectively.

3. SHORT-TERM AND LONG-TERM INVESTMENTS

The Company s short-term and long-term investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company s investment guidelines and market conditions. 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 primarily 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 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 an impairment in 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, 2008, the Company has recorded the estimated fair value in available-for-sale securities for short-term and long-term investments of approximately $578.5 million and $61.7 million, respectively.

Available-for-sale securities consist of the following at March 31, 2008 (amounts in thousands):

	MARCH 31, 2008			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate notes and bonds	$ 239,569	$ 1,062	$ (1,036)	$ 239,595
Federal agency notes and bonds	229,245	2,780		232,025
Auction rate floating securities	44,900		(783)	44,117

Asset-backed securities	69,667	875	(76)	70,466
Commercial paper	53,978	80	(12)	54,046
Total securities	$ 637,359	$ 4,797	$ (1,907)	$ 640,249

Table of Contents

During the three months ended March 31, 2008, the gross realized gains on sales of available-for-sale securities totaled $210,028 while gross losses of $92,673 were realized. Such amounts of gains and losses are determined based on the specific identification method. The net adjustment to unrealized gains during the three months ended March 31, 2008, on available-for-sale securities included in stockholders equity totaled $1,112,624. The amortized cost and estimated fair value of the available-for-sale securities at March 31, 2008, by maturity, are shown below (amounts in thousands):

	MARCH 31, 2008	
	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	$ 389,951	$ 390,903
Due after one year through five years	202,508	205,229
Due after five years through 10 years		
Due after 10 years	44,900	44,117
	$ 637,359	$ 640,249

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, 2008, approximately $61.7 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 it is management s intent to hold these investments until recovery of fair value, which may be maturity.

As of March 31, 2008, the Company s investments included $44.1 million of auction rate floating securities. 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 recent negative conditions in the credit markets 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 make the securities liquid until a future auction on these investments is successful. As a result of the lack of liquidity of these investments, at March 31, 2008, the Company recorded an unrealized loss of $0.8 million on its auction rate floating securities in accumulated other comprehensive income.

Table of Contents

The following table shows the gross unrealized losses and 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, 2008 (amounts in thousands):

	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Corporate notes and bonds	$ 89,354	$ 1,033	$	$
Auction rate floating securities	44,117	783		
Asset-backed securities			3,294	76
Commercial paper	5,939	12	6,569	2
Total securities	$ 139,410	$ 1,828	$ 9,863	$ 78

The unrealized losses on the Company s investments were caused primarily by interest rate increases. It is expected that the investments will not be settled at a price less than the amortized cost. Because the Company has the ability, and intent, to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other than temporarily impaired at March 31, 2008.

4. FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 157 as of January 1, 2008. Although the adoption of SFAS No. 157 did not materially impact the Company s financial condition, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements.

SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of March 31, 2008, 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, and the Company s investment in Revance Therapeutics, Inc. (Revance).

The Company has invested in auction rate floating securities, which are classified as available-for-sale securities and reflected at fair value. However, due to recent 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 3). Therefore, the fair values of these auction rate floating securities are estimated utilizing a discounted cash flow analysis or other type of valuation model as of March 31, 2008. 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.

As a result of the temporary declines in fair value for the Company s auction rate floating securities, which the Company attributes to liquidity issues rather than credit issues, it has recorded an

Table of Contents

unrealized loss of $0.8 million in accumulated other comprehensive income. The majority of the auction rate floating securities held by the Company at March 31, 2008, totaling $44.1 million, were in securities collateralized by student loan portfolios. These securities were included in long-term investments at March 31, 2008 in the accompanying condensed consolidated balance sheets. As of March 31, 2008, the Company continued to earn interest on virtually all of its auction rate floating securities. Any future fluctuation in fair value related to these investments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income. If the Company determines that any future valuation adjustment was other than temporary, it would record a charge to earnings as appropriate.

The Company estimates changes in the net realizable value of its investment in Revance based on a hypothetical liquidation at book value approach (see Note 5). During the three months ended March 31, 2008, the Company reduced the carrying value of its investment in Revance by approximately $2.9 million as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of March 31, 2008.

The Company s assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS No. 157 at March 31, 2008, were as follows (in thousands):

		Fair Value Measurement at Reporting Date Using		
	Mar. 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Auction rate floating securities	$ 44,117	$	$	$ 44,117
Other available-for-sale securities	596,132	596,132		
Investment in Revance	9,086			9,086
Total assets measured at fair value	$ 649,335	$ 596,132	$	$ 53,203

Based on market conditions, the Company changed its valuation methodology for auction rate floating securities to a discounted cash flow analysis during the three months ended March 31, 2008. Accordingly, these securities changed from Level 1 to Level 3 within SFAS No. 157 s hierarchy since the Company s initial adoption of SFAS No. 157 at January 1, 2008.

Table of Contents

The following table presents the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in SFAS No. 157 at March 31, 2008 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Auction Rate Floating Securities	Investment in Revance
Balance at Jan. 1, 2008	$	$ 11,957
Transfers to Level 3	101,650	
Total gains (losses) included in earnings		(2,871)
Total gains (losses) included in other comprehensive income	(783)	
Purchases and settlements (net)	(56,750)	
Balance at Mar. 31, 2008	$ 44,117	$ 9,086

5. INVESTMENT IN REVANCE

On December 11, 2007, the Company announced a strategic collaboration with Revance, a privately-held, venture-backed development-stage entity, whereby the Company made an equity investment in Revance and purchased an option to acquire Revance or to license exclusively in North America Revance s novel topical botulinum toxin type A product currently under clinical development. The consideration to be paid to Revance upon the Company s exercise of the option will be at an amount that will approximate the then fair value of Revance or the license of the product under development, as determined by an independent appraisal. The option period will extend through the end of Phase 2 testing in the United States. In consideration for the Company s $20.0 million payment, the Company received preferred stock representing an approximate 13.7 percent ownership in Revance, or approximately 11.7 percent on a fully diluted basis, and the option to acquire Revance or to license the product under development. The $20.0 million is expected to be used by Revance primarily for the development of the product. $12.0 million of the $20.0 million payment represents the fair value of the investment in Revance at the time of the investment and is included in other long-term assets in the Company s condensed consolidated balance sheets as of December 31, 2007. The remaining $8.0 million, which is non-refundable and is expected to be utilized in the development of the new product, represents the residual value of the option to acquire Revance or to license the product under development and was recognized as research and development expense during the three months ended December 31, 2007.

Prior to the exercise of the option, Revance will remain primarily responsible for the worldwide development of Revance s topical botulinum toxin type A product in consultation with the Company in North America. The Company will assume primary responsibility for the development of the product should consummation of either a merger or a license for topically delivered botulinum toxin type A in North America be completed under the terms of the option. Revance will have sole responsibility for manufacturing the development product and manufacturing the product during commercialization worldwide. The Company s right to exercise the option is triggered upon Revance s successful completion of certain regulatory milestones through the end of Phase 2 testing in the United States. A license would contain a payment upon exercise of the license option, milestone payments related to clinical, regulatory and commercial achievements, and royalties based on sales defined in the license. If the Company elects to exercise the option, the financial terms for the acquisition or license will be determined through an independent valuation in accordance with specified methodologies.

The Company estimates the impairment and/or the net realizable value of the investment based on a hypothetical liquidation at book value approach as of the reporting date, unless a quantitative valuation metric is available for these purposes (such as the completion of an equity financing by Revance). The amount of the Company s investment that will be expensed periodically is uncertain due to the timing of Revance s expenditures for research and development of the product, and any charges will not be immediately, if ever, deductible for income tax

purposes and will increase the Company s effective tax

Table of Contents

rate. Further equity investments, if any, will also be subject to the same accounting treatment as the Company s original equity investment. During the three months ended March 31, 2008, the Company reduced the carrying value of its investment in Revance by approximately $2.9 million as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of March 31, 2008. The $2.9 million was recognized as other expense during the three months ended March 31, 2008.

A business entity is subject to the consolidation rules of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities an Interpretation of Accounting Research Bulletin No. 51* (FIN 46) and is referred to as a variable interest entity if it lacks sufficient equity to finance its activities without additional financial support from other parties or its equity holders lack adequate decision making ability based on criteria set forth in FIN 46. FIN 46 also requires disclosures about variable interest entities that a company is not required to consolidate, but in which a company has a significant variable interest. The Company has determined that Revance is a variable interest entity and that the Company is not the primary beneficiary, and therefore the Company s equity investment in Revance currently does not require the Company to consolidate Revance into its financial statements. The consolidation status could change in the future, however, depending on changes in the Company s relationship with Revance.

6. SEGMENT AND PRODUCT INFORMATION

The Company operates in one significant business segment: pharmaceuticals. The Company s current pharmaceutical franchises are divided between the dermatological and non-dermatological fields. The dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. The non-dermatological field represents products for the treatment of urea cycle disorder and contract revenue. The acne and acne-related dermatological product lines include DYNACIN®, PLEXION®, SOLODYN®, TRIAZ® and ZIANA®. The non-acne dermatological product lines include 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 AMMONUL® and BUPHENYL®, are promoted to dermatologists, podiatrists and plastic surgeons. Such products are often prescribed by physicians outside these three specialties; including family practitioners, general practitioners, primary-care physicians and OB/GYNs, as well as hospitals, government agencies and others. Currently, all products are sold primarily to wholesalers and retail chain drug stores.

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,	
	2008	**2007**
Acne and acne-related dermatological products	$ 83,706	$ 45,948
Non-acne dermatological products	37,766	40,643
Non-dermatological products	9,834	8,523
Total net revenues	$ 131,306	$ 95,114

	THREE MONTHS ENDED MARCH 31,	
	2008	**2007**
Acne and acne-related dermatological products	64%	48%
Non-acne dermatological products	29	43

Non-dermatological products	7	9
Total net revenues	100%	100%

Table of Contents

7. INVENTORIES

The Company utilizes third parties to manufacture and package inventories held for sale, takes title to certain inventories once manufactured, and warehouses such goods until packaged for final distribution and sale. Inventories consist of salable products held at the Company s warehouses, as well as 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, 2008 and December 31, 2007, there are no costs capitalized into inventory for products that have not yet received regulatory approval.

Inventories are as follows (amounts in thousands):

	March 31,2008	December 31,2007
Raw materials	$ 9,764	$ 9,002
Finished goods	21,328	24,789
Valuation reserve	(4,396)	(3,818)
Total inventories	$ 26,696	$ 29,973

8. 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, 2008 or December 31, 2007. 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, and contingent interest, if any, to the date of the repurchase, payable in cash. Pursuant to SFAS No. 48, *Classification of Obligations That Are Callable by the Creditor*, 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.

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

Table of Contents

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. The New Notes mature on June 4, 2033.

The Company may redeem some or all of the New Notes at any time on or after June 11, 2008, at a redemption price, payable in cash, of 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the New Notes may require the Company to repurchase all or a portion of their New Notes on June 4, 2008, June 4, 2013 and June 4, 2018, and upon a change in control (as defined in the indenture governing the New Notes), at 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash. Pursuant to SFAS No. 48, *Classification of Obligations That Are Callable by the Creditor*, 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 New Notes along with the deferred tax liability associated with the accelerated interest deductions on the New Notes will be classified as a current liability during the respective twelve months periods prior to June 4, 2008, June 4, 2013 and June 4, 2018. As of March 31, 2008, $283.9 million of the New Notes and $33.2 million of deferred tax liabilities were classified as current liabilities in the Company s condensed consolidated balance sheets. If all of the New Notes are put back to the Company on June 4, 2008, the Company would be required to pay $283.9 million in outstanding principal, plus accrued interest. The Company would also be required to pay the accumulated deferred tax liability related to the New Notes.

Table of Contents

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

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

if the Company has called the New Notes for redemption;

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

upon the occurrence of specified corporate transactions.

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

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 is amortizing these costs over the first five-year Put period, which runs through June 4, 2008.

During the quarter ended December 31, 2006, the Old Notes met the criteria for the right of conversion into shares of the Company s Class A common stock. This right of conversion of the holders of Old Notes was triggered by the Company s Class A common stock closing above $31.96 on 20 of the last 30 trading days and the last trading day of the quarter ended December 31, 2006. The holders of Old Notes had this conversion right only until March 31, 2007. During the three months ended March 31, 2007, outstanding principal amounts of $5,000 of Old Notes were converted into shares of the Company s Class A common stock. During the quarters ended March 31, 2008 and December 31, 2007, 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.

9. 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 under SFAS 123R 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 deferred tax assets and liabilities for temporary

Table of Contents

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 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, 2008 the Company has an unrealized tax loss of $12.2 million related to the Company s option to acquire Revance or license Revance s product that is under development. The Company has currently assessed that the unrealized loss would result in a capital loss carryover if realized. Due to tax limitations on the utilization of capital loss carryovers, the Company recorded a valuation allowance of $3.3 million against the capital loss carryover as of December 31, 2007. The valuation allowance increased $1.1 million to $4.4 million during the three months ended March 31, 2008.

During the three months ended March 31, 2008 and March 31, 2007, the Company made net tax payments of $11.3 million and $12.4 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 fiscal 2004. The Internal Revenue Service has recently informed the Company that the tax return for the six-month Transition Period ending December 31, 2005 has been selected for a limited scope examination.

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 limitation may be open for up to five years from the date the tax return was filed. Thus, all returns filed since this entity s formation in fiscal 2003 are open under the statute of limitation.

The Company and its consolidated subsidiaries received a final notice of proposed assessment in January 2007 from the Arizona Department of Revenue for fiscal years ended 2001 through 2004. The Company and the Arizona Department of Revenue agreed to the resolution of certain proposed adjustments, and the Company included a net $315,000 negotiated settlement amount in income taxes payable in its condensed consolidated balance sheets as of December 31, 2007. The Company paid the $315,000 negotiated settlement amount during the three months ended March 31, 2008.

At December 31, 2007, the Company had $2.1 million in unrecognized tax benefits, the recognition of which would have a favorable effect of $1.4 million on the Company s effective tax rate. The amount of unrecognized tax benefits decreased $0.9 million from $2.1 million to $1.2 million during the three months ended March 31, 2008 as part of the settlement with the Arizona Department of Revenue. Recognition of the $1.2 million unrecognized tax benefits would have a favorable effect of $800,000 on the Company s effective tax rate.

The Company recognizes accrued interest and penalties, if applicable, related to unrecognized tax benefits in income tax expense. The Company has accrued approximately $200,000 and $125,000 (net of tax benefits) for the payment of interest and penalties at December 31, 2007, and March 31, 2008, respectively.

10. DIVIDENDS DECLARED ON COMMON STOCK

On March 12, 2008, the Company declared a cash dividend of $0.04 per issued and outstanding share of its Class A common stock payable on April 30, 2008 to stockholders of record at the close of business on April 1, 2008. The $2.3 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, 2008.

Table of Contents

11. SHARE REPURCHASE PROGRAM

On August 29, 2007, the Company s Board of Directors approved a stock trading plan to purchase up to $200.0 million in aggregate value of shares of Medicis Class A common stock upon satisfaction of certain conditions. The number of shares to be repurchased and the timing of the repurchases (if any) will depend on factors such as the market price of Medicis Class A common stock, economic and market conditions, and corporate and regulatory requirements. The plan is scheduled to terminate on the earlier of the first anniversary of the plan or at the time when the aggregate purchase limit is reached. As of May 12, 2008, no shares had been repurchased under this plan.

12. COMPREHENSIVE INCOME

Total comprehensive income includes net income and other comprehensive income, which consists of foreign currency translation adjustments and unrealized gains and losses on available-for-sale investments. Total comprehensive income for the three months ended March 31, 2008 was $23.1 million. Total comprehensive income for the three months ended March 31, 2007 was $9.4 million.

Table of Contents

13. 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):

	THREE MONTHS ENDED MARCH 31,	
	2008	**2007**
BASIC		
Net income	$ 22,054	$ 9,288
Weighted average number of common shares outstanding	56,358	55,626
Basic net income per common share	$ 0.39	$ 0.17
DILUTED		
Net income	$ 22,054	$ 9,288
Add:		
Tax-effected interest expense and issue costs related to Old Notes	666	836
Tax-effected interest expense and issue costs related to New Notes	851	839
Net income assuming dilution	$ 23,571	$ 10,963
Weighted average number of common shares	56,358	55,626
Effect of dilutive securities:		
Old Notes	5,823	5,823
New Notes	7,325	7,325
Stock options and restricted stock	826	2,946
Weighted average number of common shares assuming dilution	70,332	71,720
Diluted net income per common share	$ 0.34	$ 0.15

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

The diluted net income per common share computation for the three months ended March 31, 2008 and 2007 excludes 7,667,494 and 3,096,698 shares of stock, respectively, that represented outstanding stock options whose exercise price were greater than the average market price of the common shares during the period and were

anti-dilutive.

Table of Contents

14. CONTINGENCIES

On January 15, 2008, IMPAX Laboratories, Inc. (IMPAX) filed a lawsuit against the Company in the United States District Court for the Northern District of California seeking a declaratory judgment that our U.S. Patent No. 5,908,838 related to SOLODYN® is invalid and is not infringed by IMPAX s filing of an Abbreviated New Drug Application for a generic version of SOLODYN®. On April 16, 2008, the Court granted Medicis motion to dismiss the IMPAX complaint for lack of jurisdiction. It is not known whether IMPAX will file an appeal.

On April 25, 2007, the Company entered into a Settlement Agreement with the Justice Department, the Office of Inspector General of the Department of Health and Human Services (OIG) and the TRICARE Management Activity (collectively, the United States) and private complainants to settle all outstanding federal and state civil suits against the Company in connection with claims related to the Company s alleged off-label marketing and promotion of LOPROX® and LOPROX® TS products to pediatricians during periods prior to the Company s May 2004 disposition of its pediatric sales division (the Settlement Agreement). The settlement is neither an admission of liability by the Company nor a concession by the United States that its claims are not well founded. Pursuant to the Settlement Agreement, the Company agreed to pay approximately $10 million to settle the matter. Pursuant to the Settlement Agreement, the United States released the Company from the claims asserted by the United States and agreed to refrain from instituting action seeking exclusion from Medicare, Medicaid, the TRICARE Program and other federal health care programs for the alleged conduct. These releases relate solely to the allegations related to the Company and do not cover individuals. The Settlement Agreement also provides that the private complainants release the Company and its officers, directors and employees from the asserted claims, and the Company releases the United States and the private complainants from asserted claims. During 2006, the Company accrued a loss contingency of $10.2 million for this matter in connection with the possibility of additional expenses related to the settlement amount. During the three months ended June 30, 2007, $5.8 million of the settlement amount was paid pursuant to the terms of the Settlement Agreement, and the remaining $4.4 million of the settlement amount was paid during the three months ended September 30, 2007.

As part of the Settlement Agreement, on April 25, 2007 the Company entered into a five-year Corporate Integrity Agreement (the CIA) with the OIG to resolve any potential administrative claims the OIG may have arising out of the government s investigation. The CIA acknowledges the existence of the Company s comprehensive existing compliance program and provides for certain other compliance-related activities during the term of the CIA, including the maintenance of a compliance program that, among other things, is designed to ensure compliance with the CIA, federal health care programs and FDA requirements. Pursuant to the CIA, the Company is required to notify the OIG, in writing, of: (i) any ongoing government investigation or legal proceeding involving an allegation that the Company has committed a crime or has engaged in fraudulent activities; (ii) any other matter that a reasonable person would consider a probable violation of applicable criminal, civil, or administrative laws; (iii) any written report, correspondence, or communication to the FDA that materially discusses any unlawful or improper promotion of the Company s products; and (iv) any change in location, sale, closing, purchase, or establishment of a new business unit or location related to items or services that may be reimbursed by Federal health care programs. The Company is also subject to periodic reporting and certification requirements attesting that the provisions of the CIA are being implemented and followed, as well as certain document and record retention mandates. Failure to comply under the CIA could result in substantial civil or criminal penalties and being excluded from government health care programs, which would materially reduce our sales and adversely affect our financial condition and results of operations.

On or about October 12, 2006, the Company and the United States Attorney s Office for the District of Kansas entered into a Nonprosecution Agreement wherein the government agreed not to prosecute the Company for any alleged criminal violations relating to the alleged off-label marketing and promotion of LOPROX® and LOPROX® TS. In connection with the government investigation, four employees, including Richard Havens, the Company s former Executive Vice President, Sales and Marketing, separated from the Company as of April 1, 2008. In May 2008, five of the Company s former employees, including Mr. Havens, plead or will plead guilty to misdemeanors in connection with their

Table of Contents

individual roles in the Company s alleged past off-label marketing and promotion of LOPROX® and LOPROX® TS.

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 or financial condition of the Company.

15. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Statements and Financial Liabilities*, which provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, *Fair Value Measurements,* and No. 107, *Disclosures about Fair Value of Financial Instruments.* The Company adopted SFAS No. 159 as of January 1, 2008, and the Company has not elected to exercise the fair value irrevocable option. The adoption of SFAS No. 159 did not have a material effect on the Company s consolidated results of operations and financial condition.

In June 2007, the EITF reached a consensus on EITF 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*. EITF 07-03 concludes that non-refundable advance payments for future research and development activities should be deferred and capitalized until the goods have been delivered or the related services have been performed. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. This consensus is effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier adoption is not permitted. The effect of applying the consensus will be prospective for new contracts entered into on or after that date. The Company adopted EITF 07-03 as of January 1, 2008, and it did not have a material impact on the Company s consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which replaces SFAS No. 141 and establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any controlling interest. It also established principles and requirements for how an acquirer in a business combination recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently evaluating SFAS No. 141R and its impact, if any, on the Company s consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51*. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest, or minority interest, as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the statement of operations. SFAS No. 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains it controlling financial interest. In addition, this statement requires that a parent

Table of Contents

recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating SFAS No. 160 and its impact, if any, on our consolidated results of operations and financial condition.

In December 2007, the EITF reached a consensus on EITF 07-01, *Accounting for Collaborative Agreements*. EITF 07-01 prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in EITF Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, and other applicable accounting literature. The consensus should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. The consensus is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating EITF 07-01 and its impact, if any, on our consolidated results of operations and financial condition.

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, aesthetic and podiatric conditions. We also market products in Canada for the treatment of dermatological and aesthetic conditions. We offer a broad range of products addressing various conditions or aesthetics improvements, including facial wrinkles, acne, fungal infections, rosacea, 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®. Our non-acne dermatological product lines include 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.

Key Aspects of Our Business

We derive a majority of our revenue from our primary products: PERLANE®, RESTYLANE®, SOLODYN®, TRIAZ®, VANOS® and ZIANA®. We believe that sales of our primary products will constitute a significant portion of our sales for the foreseeable future.

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 podiatrists and the leading plastic surgeons in the U.S. We rely on third parties to manufacture our products.

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 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 65%-75% 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 provisions. 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 recently entered into 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 supplied by our major

Table of Contents

wholesalers. We rely wholly upon our wholesale and drug chain customers to effect the distribution allocation of substantially all of our products. We believe the 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 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 drugstore and wholesale customers. We believe such availability reduces the probability of local and regional product substitutions, shortages and backorders, which could result in lost sales. We expect to continue providing favorable terms to wholesale and retail drug chain customers as may be necessary to ensure the fullest possible distribution of our branded products within the pharmaceutical chain of commerce.

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.

Recent Developments

The following significant events and transactions occurred during the three months ended March 31, 2008 and affected our results of operations, our cash flows and our financial condition:

Reduction in the carrying value of our investment in Revance

On December 11, 2007, we announced a strategic collaboration with Revance Therapeutics, Inc. (Revance), a privately-held, venture-backed development-stage company, whereby we made an equity investment in Revance and purchased an option to acquire Revance or to license exclusively in North America Revance s novel topical botulinum toxin type A product currently under clinical development. The consideration to be paid to Revance upon our exercise of the option will be at an amount that will approximate the then fair value of Revance or the license of the product under development, as determined by an independent appraisal. The option period will extend through the end of Phase 2 testing in the United States. In consideration for our $20.0 million payment, we received preferred stock representing an approximate 13.7 percent ownership in Revance, or approximately 11.7 percent on a fully diluted basis, and the option to acquire Revance or to license the product under development. The $20.0 million is expected to be used by Revance primarily for the development of the product. $12.0 million of the $20.0 million payment represents the fair value of the investment in Revance at the time of the investment and was included in other long-term assets in our condensed consolidated balance sheets as of December 31, 2007. The remaining $8.0 million, which is non-refundable and is expected to be utilized in the development of the new product, represents the residual value of the option to acquire Revance or to license the product under development and was recognized as research and development expense during the three months ended December 31, 2007.

We estimate the impairment and/or the net realizable value of the Revance investment based on a hypothetical liquidation at book value approach as of the reporting date, unless a quantitative valuation metric is available for these purposes (such as the completion of an equity financing by Revance). The amount or our investment that will be expensed periodically is uncertain due to the timing of Revance s expenditures for research and development of the product, and any charges will not be immediately, if ever, deductible for income tax purposes and will increase our effective tax rate. Further equity investments, if any, will also be subject to the same accounting treatment as our original equity investment.

Table of Contents

During the three months ended March 31, 2008, we reduced the carrying value of our investment in Revance by approximately $2.9 million as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of March 31, 2008. We recognized the $2.9 million as other expense in our condensed consolidated statement of operations during the three months ended March 31, 2008.

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, 2008 (a)	MARCH 31, 2007 (b)
Net revenues	100.0%	100.0%
Gross profit (c)	91.5	89.0
Operating expenses	67.0	79.6
Operating income	24.5	9.4
Other expense	2.2	
Interest and investment (income) expense, net	(5.2)	(6.7)
Income before income tax expense	27.5	16.1
Income tax expense	10.7	6.3
Net income	16.8%	9.8%

(a) Included in operating expenses is $4.4 million (3.3% of net revenues) of compensation expense related to stock options and restricted stock.

(b) Included in operating expenses is $5.5 million (5.8% of net revenues) of compensation expense related to stock options

and restricted stock.

(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, 2008 Compared to the Three Months Ended March 31, 2007
Net Revenues

The following table sets forth our net revenues for the three months ended March 31, 2008 (the first quarter of 2008) and March 31, 2007 (the first quarter of 2007), along with the percentage of net revenues and percentage point change for each of our product categories (dollar amounts in millions):

	First Quarter 2008	First Quarter 2007	$ Change	% Change
Net product revenues	$ 127.5	$ 92.4	$ 35.1	38.0%
Net contract revenues	3.8	2.7	1.1	40.4%
Net revenues	$ 131.3	$ 95.1	$ 36.2	38.1%

	First Quarter 2008	First Quarter 2007	$ Change	% Change
Acne and acne-related dermatological products	$ 83.7	$ 46.0	$ 37.7	82.2%
Non-acne dematological products	37.8	40.6	(2.8)	(7.1)%
Non-dermatological products (including contract revenues)	9.8	8.5	1.3	15.4%
Total net revenues	$ 131.3	$ 95.1	$ 36.2	38.1%

	First Quarter 2008	First Quarter 2007	Change
Acne and acne-related dermatological products	63.7%	48.3%	15.4%
Non-acne dermatological products	28.8%	42.7%	(13.9)%
Non-dermatological products	7.5%	9.0%	(1.5)%
Total net revenues	100.0%	100.0%	

Our total net revenues increased during the first quarter of 2008 primarily as a result of increased sales of SOLODYN® and ZIANA®. Net revenues associated with our acne and acne-related dermatological products increased as a percentage of net revenues from 48.3% during the first quarter of 2007 to 63.7% during the first quarter of 2008, and increased in net dollars by 82.2% during the first quarter of 2008 as compared to the first quarter of 2007 as a result of increased sales of SOLODYN® and ZIANA®. ZIANA® was formally launched to the market during the first quarter of 2007. Net revenues associated with our non-acne dermatological products decreased as a percentage of net revenues, and decreased in net dollars by 7.1% during the first quarter of 2008. Net revenues associated with our non-acne dermatological products for the first quarter of 2007 included revenues related to OMNICEF®, which we are no longer promoting. Net revenues associated with our non-dermatological products decreased as a percentage of net revenues, but increased in net dollars by 15.4% during the first quarter of 2008 as compared to the first quarter of

2007, primarily due to an increase in contract revenue.

Net revenues associated with our non-acne dermatological products decreased $9.1 million, or 19.5%, from the fourth quarter of 2007 primarily due to seasonality of the RESTYLANE® brands combined with current economic and market conditions in the aesthetic market and decreases in prescription volume related to other products in this category.

Table of Contents

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 2008 and 2007 was approximately $5.3 million and $4.8 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 2008 and 2007, along with the percentage of net revenues represented by such gross profit (dollar amounts in millions):

	First Quarter 2008	First Quarter 2007	$ Change	% Change
Gross profit	$ 120.2	$ 84.6	$ 35.6	42.1%
% of net revenues	91.5%	89.0%		

The increase in gross profit during the first quarter of 2008, compared to the first quarter of 2007, was due to the increase in our net revenues, and the increase in gross profit as a percentage of net revenues was primarily due to the different mix of products sold during the first quarter of 2008 as compared to the first quarter of 2007. Increased sales of SOLODYN®, a higher margin product, during the first quarter of 2008, was the primary change in the mix of products sold during the comparable periods that affected gross profit as a percentage of net revenues.

Selling, General and Administrative Expenses

The following table sets forth our selling, general and administrative expenses for the first quarter of 2008 and 2007, along with the percentage of net revenues represented by selling, general and administrative expenses (dollar amounts in millions):

	First Quarter 2008	First Quarter 2007	$ Change	% Change
Selling, general and administrative	$ 72.1	$ 62.3	$ 9.8	15.7%
% of net revenues	54.9%	65.5%		
Share-based compensation expense included in selling, general and administrative	$ 4.3	$ 5.4	$ (1.1)	(19.5)%

The increase in selling, general and administrative expenses during the first quarter of 2008 from the first quarter of 2007 was attributable to approximately $4.5 million of increased personnel costs, primarily related to an increase in the number of employees increasing from 435 as of March 31, 2007 to 496 as of March 31, 2008 and the effect of the annual salary increase that occurred during February 2008, $5.9 million of increased professional and consulting expenses, including costs related to patent litigation associated with our SOLODYN® product and the implementation of our new enterprise resource planning (ERP) system, partially offset by a net reduction of $0.6 million of other additional selling, general and administrative costs incurred during the first quarter of 2008. We expect to continue to incur increased legal and other professional fees during 2008 as a result of patent protection related to our SOLODYN® and VANOS® products.

Table of Contents

Research and Development Expenses

The following table sets forth our research and development expenses for the first quarter of 2008 and 2007 (dollar amounts in millions):

	First Quarter 2008	First Quarter 2007	$ Change	% Change
Research and development	$ 9.2	$ 8.0	$1.2	14.8%
Share-based compensation expense included in research and development	0.1	0.1	$	%

The primary product under development during the first quarter of 2008 and 2007 was RELOXIN®. 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.

In accordance with our development and distribution agreement with Ipsen for the development of RELOXIN®, we will pay Ipsen $25.0 million upon the FDA s acceptance of our Biologics License Application (BLA) for RELOXIN®, which we will recognize as research and development expense when incurred. On March 17, 2008, we announced that the BLA had been re-submitted to the FDA. We will pay Ipsen $75.0 million upon the FDA s approval of RELOXIN®.

Depreciation and Amortization Expenses

Depreciation and amortization expenses during the first quarter of 2008 increased $1.2 million, or 23.2%, to $6.7 million from $5.5 million during the first quarter of 2007. This increase was primarily due to amortization related to a $29.1 million milestone payment made to Q-Med related to the FDA approval of PERLANE® capitalized during the second quarter of 2007.

Other Expense

Other expense of $2.9 million recognized during the first quarter of 2008 represented a reduction in the carrying value of our investment in Revance as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of March 31, 2008.

Interest and Investment Income

Interest and investment income during the first quarter of 2008 increased $0.2 million, or 2.1%, to $9.2 million from $9.0 million during the first quarter of 2007, primarily due to an increase in the funds available for investment, partially offset by a decrease in the interest rates achieved by our invested funds during the first quarter of 2008.

Interest Expense

Interest expense during the first quarter of 2008 decreased $0.3 million, to $2.4 million during the first quarter of 2008 from $2.7 million during the first quarter of 2007. Our interest expense during the first quarter of 2008 and 2007 consisted of interest expense on our Old Notes, which accrue interest at 2.5% per annum, our New Notes, which accrue interest at 1.5% per annum, and amortization of fees and other origination costs related to the issuance of the Old Notes and New Notes. The decrease in interest expense during the first quarter of 2008 as compared to the first quarter of 2007 was due to the fees and origination costs related to the issuance of the Old Notes becoming fully amortized during the second quarter of 2007. See Note 7 in our accompanying condensed consolidated financial statements for further discussion on the Old Notes and New Notes. If a significant portion of the holders of the New Notes require us to repurchase their New Notes during the second quarter of 2008, we anticipate that our interest expense will decrease materially. The tax-effected net interest expense and issue cost amortization on the Old Notes and New Notes are added back to net income when computing diluted net income per share.

Table of Contents

Income Tax Expense

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 under SFAS 123R 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. Our effective tax rate may be subject to fluctuations during the year as new information is obtained which may affect the assumptions we use to estimate our annual effective tax rate, including factors such as our mix of pre-tax earnings in the various tax jurisdictions in which we operate, 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 we conduct operations. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities, along with net operating losses and credit carryforwards. We record valuation allowances against our deferred tax assets to reduce the net carrying values to amounts that management believes is more likely than not to be realized.

Our effective tax rate for the first quarter of 2008 was 39.0%, which was consistent with the 39.2% effective tax rate for the first quarter of 2007. The provision for income taxes generally reflects management s estimate of the effective tax rate expected to be applicable for the full fiscal year.

Table of Contents

Liquidity and Capital Resources

Overview

The following table highlights selected cash flow components for the first quarter of 2008 and 2007, and selected balance sheet components as of March 31, 2008 and December 31, 2007 (dollar amounts in millions):

	First Quarter 2008	First Quarter 2007	$ Change	% Change
Cash provided by (used in):				
Operating activities	$ 33.1	$ 25.8	$ 7.3	28.5%
Investing activities	61.5	(153.9)	215.4	140.0%
Financing activities	(0.9)	8.8	(9.7)	(110.6)%

	Mar. 31, 2008	Dec. 31, 2007	$ Change	% Change
Cash, cash equivalents, and short-term investments	$ 780.2	$ 794.7	$(14.5)	(1.8)%
Working capital	447.6	460.1	(12.5)	(2.7)%
Long-term investments	61.7	17.1	44.6	261.7%
2.5% contingent convertible senior notes due 2032	169.2	169.2		
1.5% contingent convertible senior notes due 2033	283.9	283.9		

Working Capital

Working capital as of March 31, 2008 and December 31, 2007 consisted of the following (dollar amounts in millions):

	Mar. 31, 2008	Dec. 31, 2007	$ Change	% Change
Cash, cash equivalents, and short-term investments	$ 780.2	$ 794.7	$ (14.5)	(1.8)%
Accounts receivable, net	27.0	12.4	14.6	117.9%
Inventories, net	26.7	30.0	(3.3)	(10.9)%
Other current assets	24.5	18.0	6.5	36.0%
Total current assets	858.4	855.1	3.3	0.4%
Accounts payable	52.8	34.9	17.9	51.3%
Current portion of long-term debt	283.9	283.9		%
Income taxes payable	6.1	7.7	(1.6)	(21.0)%
Deferred tax liabilities, net	15.4	11.7	3.7	31.4%
Other current liabilities	52.6	56.8	(4.2)	(7.4)%
Total current liabilities	410.8	395.0	15.8	4.0%
Working capital	$ 447.6	$ 460.1	$ (12.5)	(2.7)%

We had cash, cash equivalents and short-term investments of $780.2 million and working capital of $447.6 million at March 31, 2008, as compared to $794.7 million and $460.1 million, respectively, at December 31, 2007. The decreases were primarily due to a net transfer of $44.7 million of our short-term investments into long-term investments, partially offset by the generation of $33.1 million of operating cash flow during the first quarter of 2008.

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, including the possible repayment of $283.9 million of contingent convertible senior notes in June of 2008 and the related accumulated deferred tax liability. Our cash and short-term investments are available for dividends, 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

Table of Contents

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 December 31, 2007, our short-term investments included $101.7 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. The recent negative conditions in the credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008 we sold $56.8 million of auction rate floating securities, but there was insufficient demand at auction for the remaining $44.9 million of auction rate floating securities in our portfolio. 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. We may not be able to make the securities liquid until a future auction on these investments is successful. As a result of the lack of liquidity of these investments at March 31, 2008, we recorded an unrealized loss of $0.8 million on our auction rate floating securities in accumulated other comprehensive income in our condensed consolidated balance sheets.

During July 2006, we executed a lease agreement for new headquarter office space to accommodate our expected long-term growth. The first phase is for approximately 150,000 square feet with the right to expand. We expect to occupy the new headquarter office space, which is located approximately one mile from our current headquarter office space in Scottsdale, Arizona, in the second quarter of 2008. There is no cash obligation for lease payments until 2009. We obtained possession of the leased premises and therefore began accruing rent expense during the first quarter of 2008. Rent expense recognized during the first quarter of 2008 related to this property was approximately $1.1 million. During the first quarter of 2008, we received approximately $6.7 million in tenant improvement incentives from the landlord. This amount has been capitalized into leasehold improvements and is being depreciated on a straight-line basis over the lesser of the useful life or the term of the lease. The tenant improvement incentives are also included in other long-term liabilities as deferred rent, and will be recognized as a reduction of rent expense on a straight-line basis over the term of the lease. In 2008, upon vacating our existing headquarters facility, we will be required to record a charge for the estimated remaining net cost for the lease, net of potential sublease income. Total lease payments remaining after June 30, 2008 on our existing headquarters facility total approximately $5.3 million.

During 2007, we began designing and implementing a new enterprise resource planning (ERP) system to integrate and improve the financial and operational aspects of our business. During 2007 and the three months ended March 31, 2008, we invested approximately $9.5 million and $2.4 million, respectively, on this project.

Operating Activities

Net cash provided by operating activities during the first quarter of 2008 was approximately $33.1 million, compared to cash provided by operating activities of approximately $25.8 million during the first quarter of 2007. The following is a summary of the primary components of cash provided by (used in) operating activities during the first quarter of 2008 and 2007 (in millions):

	First Quarter 2008	First Quarter 2007
Income taxes paid	$ (11.3)	$ (12.4)
Other cash provided by operating activities	44.4	38.2
Cash provided by operating activities	$ 33.1	$ 25.8

Table of Contents

Investing Activities

Net cash provided by investing activities during the first quarter of 2008 was approximately $61.5 million, compared to net cash used in investing activities during the first quarter of 2007 of $153.9 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 used in financing activities during the first quarter of 2008 was $0.9 million, compared to net cash provided by financing activities of $8.8 million during the first quarter of 2007. This change is primarily due to the proceeds from the exercise of stock options, which were $0.8 million during the first quarter of 2008 compared to $9.6 million during the first quarter of 2007. Dividends paid during both the first quarter of 2008 and the first quarter of 2007 was $1.7 million.

Contingent Convertible Senior Notes and Other Long-Term Commitments

We have two outstanding series of Contingent Convertible Senior Notes, consisting of $169.2 million principal amount of 2.5% Contingent Convertible Senior Notes due 2032 (the Old Notes) and $283.9 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, 2008, 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. If all of the New Notes are put back to us on June 4, 2008, we would be required to pay $283.9 million in outstanding principal, plus outstanding accrued interest. We would also be required to pay an accumulated deferred tax liability related to the New Notes. The deferred tax liability related to the New Notes as of March 31, 2008 was $33.2 million. Unless we find alternative financing, any such payments would be made from available cash, cash equivalents and short-term investments. If, at June 4, 2008, such funds are not available, and significant portion of the holders of the New Notes require us to repurchase their New Notes, we may not have sufficient funds to make the required repurchases and pay the deferred tax liability.

Except for the Old Notes, we had only $13.8 million of long-term liabilities at March 31, 2008. Except for the New Notes and deferred tax liabilities, we had only $111.5 million of current liabilities at March 31, 2008. 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. In addition, we will be continuing our implementation of a new ERP system during 2008, which will require financial expenditures to complete.

We have made available to BioMarin Pharmaceutical Inc. (BioMarin) the ability to draw down on a Convertible Note up to $25.0 million beginning July 1, 2005 (the Convertible Note). The Convertible Note is convertible based on certain terms and conditions including a change of control provision. Money advanced under the Convertible Note is convertible into BioMarin shares at a strike price equal to the BioMarin average closing price for the 20 trading days prior to such advance. The Convertible Note matures on the option purchase date in 2009 as defined in the securities purchase agreement entered into on May 18, 2004, but may be repaid by BioMarin at any time prior to the option purchase date. As of May 12, 2008, BioMarin has not requested any monies to be advanced under the Convertible Note, and no amounts are outstanding.

Table of Contents

Repurchases of Common Stock

On August 29, 2007, our Board of Directors approved a stock trading plan to purchase up to $200.0 million in aggregate value of shares of our Class A common stock upon satisfaction of certain conditions. The number of shares to be repurchased and the timing of the repurchases (if any) will depend on factors such as the market price of our Class A common stock, economic and market conditions, and corporate and regulatory requirements. The plan is scheduled to terminate on the earlier of the first anniversary of the plan or at the time when the aggregate purchase limit is reached. As of May 12, 2008, no shares had been repurchased under this plan.

Dividends

We do not have a dividend policy. Since July 2003, we have paid quarterly cash dividends aggregating approximately $30.3 million on our common stock. In addition, on March 12, 2008, we declared a cash dividend of $0.04 per issued and outstanding share of common stock payable on April 30, 2008 to our stockholders of record at the close of business on April 1, 2008. Prior to these dividends, we had not paid a cash dividend on our common stock. 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

As discussed in Note 4 to the unaudited condensed consolidated financial statements, we adopted the provisions of SFAS No. 157 as of January 1, 2008. We determined that we utilize unobservable (Level 3) inputs in determining the fair value of our auction rate floating security investments, which totaled $44.1 million at March 31, 2008. These securities were included in long-term investments at March 31, 2008.

Our auction rate floating securities are classified as available for sale securities and 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 SFAS No. 157. However, due to events in credit markets 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 utilizing a discounted cash flow analysis or other type of valuation model as of March 31, 2008. 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 and recorded a temporary unrealized decline in fair value of $0.8 million, with an offsetting entry to accumulated other comprehensive income. We currently believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets for the majority of securities are almost entirely backed by the U.S. government. In addition, our holdings of auction rate floating securities represented less than ten percent of our total cash and cash equivalents, restricted cash and short-term and long-term investment balance at March 31, 2008, which we believe allows us sufficient time for the securities to return to full value. Because we believe that the current decline in fair value is temporary and based only on liquidity issues in the credit markets, any difference between our estimate and an estimate that would be arrived at by another party would have no impact on our earnings, since such difference would also be recorded to accumulated other comprehensive income. We will re-evaluate each of these factors as market conditions change in subsequent periods.

Off-Balance Sheet Arrangements

As of March 31, 2008, we are not involved in any off-balance sheet arrangements, as defined in Item 3(a)(4)(ii) of Securities and Exchange Commission (SEC) Regulation S-K.

Table of Contents

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. The preparation of the condensed consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates related to sales allowances, chargebacks, rebates, returns and other pricing adjustments, depreciation and amortization and other contingencies and litigation. We base our estimates on historical experience and various other factors related to each circumstance. Actual results could differ from those estimates based upon future events, which could include, among other risks, changes in the regulations governing the manner in which we sell our products, changes in the health care environment and managed care consumption patterns. Our significant accounting policies are described in Note 2 to the consolidated financial statements included in our Form 10-K for the year ended December 31, 2007. There were no new significant accounting estimates in the first quarter of 2008, 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, 2007.

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Statements and Financial Liabilities*, which provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. SFAS No. 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, *Fair Value Measurements,* and No. 107, *Disclosures about Fair Value of Financial Instruments*. We adopted SFAS No. 159 as of January 1, 2008, and we have not elected to exercise the fair value irrevocable option. The adoption of SFAS No. 159 did not have a material effect on our consolidated results of operations and financial condition.

In June 2007, the EITF reached a consensus on EITF 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*. EITF 07-03 concludes that non-refundable advance payments for future research and development activities should be deferred and capitalized until the goods have been delivered or the related services have been performed. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense. This consensus is effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier adoption is not permitted. The effect of applying the consensus will be prospective for new contracts entered into on or after that date. We adopted EITF 07-03 as of January 1, 2008 and it did not have a material impact on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which replaces SFAS No. 141 and establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any controlling interest. It also established principles and requirements for how an acquirer in a business combination recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating SFAS No. 141R and its impact, if any, on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51*. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the

Table of Contents

deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest, or minority interest, as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the statement of operations. SFAS No. 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains it controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We are currently evaluating SFAS No. 160 and its impact, if any, on our consolidated results of operations and financial condition.

In December 2007, the EITF reached a consensus on EITF 07-01, *Accounting for Collaborative Agreements*. EITF 07-01 prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, and other applicable accounting literature. The consensus should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. The consensus is effective for fiscal years beginning after December 15, 2008. We are currently evaluating EITF 07-01 and its impact, if any, on our consolidated 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 simil 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:

- competitive developments affecting our products, such as the recent FDA approvals of Artefill®, Radiesse®, Sculptra®, Elevess, Juvéderm Ultra and Juvéderm Ultra Plus, competitors to RESTYLANE® and PERLANE®, a generic form of our DYNACIN® Tablets product, generic forms of our LOPROX® TS and LOPROX® Cream and LOPROX® Gel products, and potential generic forms of our LOPROX® Shampoo, TRIAZ®, PLEXION®, SOLODYN® or VANOS® products;

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

Table of Contents

changes in the FDA s position on the safety or effectiveness of our products. For example, in the August 29, 2006 Federal Register, the FDA issued a notice of proposed rulemaking to categorically establish that over-the-counter skin bleaching drug products are not generally recognized as safe and effective and are misbranded. If the proposed rule is adopted, all manufacturers of skin bleaching products would be required to remove their products from the market and obtain FDA approval prior to re-entering the U.S. market. ESOTERICA® is an over-the-counter product line sold by the Company that contains bleaching products that would be regulated by the proposed rule and, if that occurs, the Company does not currently intend to invest in obtaining an approved NDA in order to continue selling this product line. This product accounted for $2.2 million and $0.4 million in net revenues during 2007 and the first quarter of 2008, respectively;

changes in our product mix;

changes in prescription levels;

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

manufacturing or supply interruptions;

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

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

the ability to successfully market both new and existing products;

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

the ability to compete against generic and other branded products;

trends toward managed care and health care cost containment;

our ability to protect our patents and other intellectual property and obtain additional patents for our primary products, including SOLODYN®;

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

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

our ability to successfully design and implement our new enterprise resource planning (ERP) system;

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;

Table of Contents

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, such as RELOXIN®;

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

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

downturns in general economic conditions that negatively affect our dermal restorative and branded prescription products; and

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

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, 2007 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 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, 2008, 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, 2007.

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, 2008 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

Table of Contents

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, 2008, 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.

On January 1, 2008, we transitioned our financial accounting and reporting processes to our new ERP system as part of a phased implementation plan. The new ERP system, which we began developing during 2007, was designed and implemented to integrate and improve the financial and operational aspects of our business. The implementation of this new ERP system involves changes to our procedures for control over financial reporting. We followed a detailed implementation plan that required significant pre-implementation planning, design and testing. We have also conducted and will continue to conduct extensive post-implementation review and process modification to ensure that internal controls over financial reporting are properly designed. To date, we have not experienced any significant difficulties in our processes related to the implementation or operation of the new ERP system.

Table of Contents

Part II. Other Information

Item 1. Legal Proceedings

On January 15, 2008, IMPAX Laboratories, Inc. (IMPAX) filed a lawsuit against us in the United States District Court for the Northern District of California seeking a declaratory judgment that our U.S. Patent No. 5,908,838 related to SOLODYN® is invalid and is not infringed by IMPAX s filing of an Abbreviated New Drug Application (ANDA) for a generic version of SOLODYN®. On April 16, 2008, the Court granted Medicis motion to dismiss the IMPAX complaint for lack of jurisdiction. It is not known whether IMPAX will file an appeal.

On April 25, 2007, we entered into a Settlement Agreement with the Justice Department, the Office of Inspector General of the Department of Health and Human Services (OIG) and the TRICARE Management Activity (collectively, the United States) and private complainants to settle all outstanding federal and state civil suits against us in connection with claims related to our alleged off-label marketing and promotion of LOPROX® and LOPROX® TS products to pediatricians during periods prior to our May 2004 disposition of our pediatric sales division (the Settlement Agreement). The settlement is neither an admission of liability by us nor a concession by the United States that its claims are not well founded. Pursuant to the Settlement Agreement, we agreed to pay approximately $10 million to settle the matter. Pursuant to the Settlement Agreement, the United States released us from the claims asserted by the United States and agreed to refrain from instituting action seeking exclusion from Medicare, Medicaid, the TRICARE Program and other federal health care programs for the alleged conduct. These releases relate solely to the allegations related to us and do not cover individuals. The Settlement Agreement also provides that the private complainants release us and our officers, directors and employees from the asserted claims, and we release the United States and the private complainants from asserted claims.

As part of the settlement, on April 25, 2007 we entered into a five-year Corporate Integrity Agreement (the CIA) with the OIG to resolve any potential administrative claims the OIG may have arising out of the government s investigation. The CIA acknowledges the existence of our comprehensive existing compliance program and provides for certain other compliance-related activities during the term of the CIA, including the maintenance of a compliance program that, among other things, is designed to ensure compliance with the CIA, federal health care programs and FDA requirements. Pursuant to the CIA, we are required to notify the OIG, in writing, of: (i) any ongoing government investigation or legal proceeding involving an allegation that we have committed a crime or has engaged in fraudulent activities; (ii) any other matter that a reasonable person would consider a probable violation of applicable criminal, civil, or administrative laws; (iii) any written report, correspondence, or communication to the FDA that materially discusses any unlawful or improper promotion of our products; and (iv) any change in location, sale, closing, purchase, or establishment of a new business unit or location related to items or services that may be reimbursed by Federal health care programs. We are also subject to periodic reporting and certification requirements attesting that the provisions of the CIA are being implemented and followed, as well as certain document and record retention mandates. We have hired a Chief Compliance Officer and created an enterprise-wide compliance function to administer our obligations under the CIA. Failure to comply under the CIA could result in substantial civil or criminal penalties and being excluded from government health care programs, which could materially reduce our sales and adversely affect our financial condition and results of operations.

On or about October 12, 2006, we and the United States Attorney s Office for the District of Kansas entered into a Nonprosecution Agreement wherein the government agreed not to prosecute us for any alleged criminal violations relating to the alleged off-label marketing and promotion of LOPROX® and LOPROX® TS. In connection with the government investigation, four employees, including Richard Havens, our former Executive Vice President, Sales and Marketing, separated from the Company as of April 1, 2008. In May 2008, five of our former employees, including Mr. Havens, plead or will plead guilty to misdemeanors in connection with their individual roles in the Company s alleged past off-label marketing and promotion of LOPROX® and LOPROX® TS.

Table of Contents

On October 27, 2005, we filed suit against Upsher-Smith Laboratories, Inc. of Plymouth, Minnesota and against Prasco Laboratories of Cincinnati, Ohio for infringement of Patent No. 6,905,675 entitled Sulfur Containing Dermatological Compositions and Methods for Reducing Malodors in Dermatological Compositions covering our sodium sulfacetamide/sulfur technology. This intellectual property is related to our PLEXION® Cleanser product. The suit was filed in the U.S. District Court for the District of Arizona, and seeks an award of damages, as well as a preliminary and a permanent injunction. A hearing on our preliminary injunction motion was heard on March 8 and March 9, 2006. On May 2, 2006, an order denying the motion for a preliminary injunction was received by Medicis. The Court has entered an order staying the case until the conclusion of a patent reexamination request submitted by Medicis.

On May 25, 2006, Prasco Laboratories of Cincinnati, Ohio filed suit against us and Imaginative Research Associates (IRA) seeking a declaration that Prasco s Oscion product does not infringe certain patents owned by us or by IRA. We and IRA moved to dismiss that suit on the grounds that the court had no jurisdiction under the Declaratory Judgment Act to hear the case. The court granted our motion and dismissed the case. Prasco has appealed and the appeal is pending before the U.S. Court of Appeals for the Federal Circuit.

In addition to the matters discussed above, we and certain of our subsidiaries are parties to other actions and proceedings incident to our business, including litigation regarding our intellectual property, challenges to the enforceability or validity of our intellectual property and claims that our products infringe on the intellectual property rights of others. We record contingent liabilities resulting from claims against us when it is probable (as that word is defined in Statement of Financial Accounting Standards No. 5) that a liability has been incurred and the amount of the loss is reasonably estimable. We disclose material contingent liabilities when there is a reasonable possibility that the ultimate loss will exceed the recorded liability. Estimating probable losses requires analysis of multiple factors, in some cases including judgments about the potential actions of third-party claimants and courts. Therefore, actual losses in any future period are inherently uncertain. In all of the cases noted where we are the defendant, we believe we have meritorious defenses to the claims in these actions and resolution of these matters will not have a material adverse effect on our business, financial condition, or results of operation; however, the results of the proceedings are uncertain, and there can be no assurance to that effect.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves a number of risks. The following discussion highlights some of these risks and others are discussed elsewhere in this report. These and other risks could materially and adversely affect our business, financial condition, prospects, operating results or cash flows.

Risks Related To Our Business

Certain of our primary products could lose patent protection in the near future and become subject to competition from generic forms of such products. If that were to occur, sales of those products would decline significantly and such decline could have a material adverse effect on our results of operations.

We depend upon patents to provide us with exclusive marketing rights for certain of our primary products for some period of time. If product patents for our primary products expire, or are successfully challenged by our competitors, in the United States and in other countries, we would face strong competition from lower price generic drugs. Loss of patent protection for any of our primary products would likely lead to a rapid loss of sales for that product, as lower priced generic versions of that drug become available. In the case of products that contribute significantly to our sales, the loss of patent protection could have a material adverse effect on our results of operations. For example, while current patent coverage for SOLODYN® does not expire until 2018, SOLODYN® may face generic competition in the near future without prior notice if a generic competitor decides to enter the market notwithstanding the risk of a suit for patent infringement. Because SOLODYN® contains an antibiotic drug that was first approved by the FDA prior to the enactment of the Food and Drug Administration Modernization Act of 1997, or FDAMA, SOLODYN® does not have the benefit of the protections offered under the Hatch-

Table of Contents

Waxman Act. Accordingly, we would not receive a Paragraph IV notice regarding SOLODYN® from any potential generic competitor and would not be entitled to an automatic 30-month stay of generic entry that would be available to a patent owner filing an infringement suit based on receipt of such a notice. We currently have one issued patent relating to SOLODYN®. As part of our patent strategy, we are currently pursuing additional patent protection for SOLODYN®. However, we cannot provide any assurance that any additional patents will be issued relating to SOLODYN® and the failure to obtain additional patent protection could adversely affect our ability to deter generic competition, which would adversely affect SOLODYN® revenue and our results of operations. On January 15, 2008, we announced that IMPAX Laboratories, Inc. (IMPAX) announced that IMPAX sent us a letter advising that IMPAX has filed an ANDA seeking FDA approval to market a generic version of SOLODYN® (minocycline HCl) extended-release capsules. IMPAX has not advised us as to the status of the FDA s review of its filing, or whether IMPAX has complied with recent FDA requirements for proving bioequivalence. Also on January 15, 2008, IMPAX filed a lawsuit against us in the United States District Court for the Northern District of California seeking a declaratory judgment that our U.S. Patent No. 5,908,838 related to SOLODYN® is invalid and is not infringed by IMPAX s ANDA for a generic version of SOLODYN®. On April 16, 2008, the Court granted Medicis motion to dismiss the IMPAX complaint for lack of jurisdiction. It is not known whether IMPAX will file an appeal. In addition to SOLODYN®, many of our primary prescription products, including VANOS®, may be subject to generic competition in the near future. If any of our primary products are rendered obsolete or uneconomical by competitive changes, including generic competition, our results of operation would be materially and adversely affected.

If we are unable to secure and protect our intellectual property and proprietary rights, or if our intellectual property rights are found to infringe upon the intellectual property rights of other parties, our business could suffer.

Our success depends in part on our ability to obtain patents or rights to patents, protect trade secrets, operate without infringing upon the proprietary rights of others, and prevent others from infringing on our patents, trademarks, service marks and other intellectual property rights.

We believe that the protection of our trademarks and service marks is an important factor in product recognition and in our ability to maintain or increase market share. If we do not adequately protect our rights in our various trademarks and service marks from infringement, their value to us could be lost or diminished. If the marks we use are found to infringe upon the trademark or service mark of another company, we could be forced to stop using those marks and, as a result, we could lose the value of those marks and could be liable for damages caused by an infringement.

The patents and patent applications in which we have an interest may be challenged as to their validity or enforceability or infringement. Any such challenges may result in potentially significant harm to our business and enable generic entry to markets for our products. The cost of responding to any such challenges and the cost of prosecuting infringement claims and any related litigation, could be substantial. In addition, any such litigation also could require a substantial commitment of our management s time. On January 15, 2008, IMPAX filed a lawsuit against us in the United States District Court for the Northern District of California seeking a declaratory judgment that our U.S. Patent No. 5,908,838 related to SOLODYN® is invalid and is not infringed by IMPAX s filing of an ANDA for a generic version of SOLODYN®. See Item 1 of Part II of this report, Legal Proceedings and Note 14, Contingencies, in the notes to the condensed consolidated financial statements under Item 1 of Part I of this report, Financial Statements, for information concerning our current intellectual property litigation.

We are pursuing several United States patent applications; although we cannot be sure that any of these patents will ever be issued. For example, on November 6, 2007, we received notification of a non-final rejection from the U.S. Patent and Trademark Office relating to certain patent applications that we filed relating to SOLODYN®. We responded promptly to the non-final rejections and are continuing our vigorous efforts to obtain additional patent protection for SOLODYN®. We also have acquired rights under certain patents and patent applications in connection with our licenses to distribute products and by assignment of rights to patents and patent applications from certain of our consultants and officers. These patents and patent applications may be subject to claims of rights by third parties. If there are conflicting claims to the same patent or patent application, we may not prevail and, even if we do have some rights in

Table of Contents

a patent or patent application, those rights may not be sufficient for the marketing and distribution of products covered by the patent or patent application.

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

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

We depend on licenses from others, and any loss of such licenses could harm our business, market share and profitability.

We have acquired the rights to manufacture, use and market certain products, including certain of our primary products. We also expect to continue to obtain licenses for other products and technologies in the future. Our license agreements generally require us to develop a market for the licensed products. If we do not develop these markets within specified time frames, the licensors may be entitled to terminate these license agreements.

We may fail to fulfill our obligations under any particular license agreement for various reasons, including insufficient resources to adequately develop and market a product, lack of market development despite our diligence and lack of product acceptance. Our failure to fulfill our obligations could result in the loss of our rights under a license agreement.

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

Table of Contents

Obtaining FDA and other regulatory approvals is time consuming, expensive and uncertain.

The process of obtaining FDA and other regulatory approvals is time consuming and expensive. Clinical trials are required and the marketing and manufacturing of pharmaceutical products are subject to rigorous testing procedures. We may not be able to obtain FDA approval to conduct clinical trials or to manufacture or market any of the products we develop, acquire or license on a timely basis or at all. Moreover, the costs to obtain approvals could be considerable, and the failure to obtain or delays in obtaining an approval could significantly harm our business performance and financial results. The FDA vigorously monitors the ongoing safety of products, which can affect the approvability of our products or the continued ability to market our products. For example, the FDA recently stated it was reviewing the safety of two botulinum toxin products currently marketed in the U.S. Even if pre-marketing approval from the FDA is received, the FDA is authorized to impose post-marketing requirements such as:

testing and surveillance to monitor the product and its continued compliance with regulatory requirements;

submitting products for inspection and, if any inspection reveals that the product is not in compliance, prohibiting the sale of all products from the same lot;

suspending manufacturing;

switching status from prescription to over-the-counter drug;

recalling products; and

withdrawing marketing clearance.

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

incurring substantial expenses, including fines, penalties, legal fees and costs to comply with the FDA s requirements;

changes in the methods of marketing and selling products;

taking FDA-mandated corrective action, which may include placing advertisements or sending letters to physicians rescinding previous advertisements or promotion; and

disruption in the distribution of products and loss of sales until compliance with the FDA s position is obtained.

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

If we market products in a manner that violates health care fraud and abuse laws, we may be subject to civil or criminal penalties.

Federal health care program anti-kickback statutes prohibit, among other things, knowingly and willfully offering, paying, soliciting or receiving remuneration to induce, or in return for purchasing, leasing, ordering or arranging for the purchase, lease or order of any health care item or service reimbursable under Medicare, Medicaid, or other federally financed health care programs. This statute has been interpreted to apply to arrangements between pharmaceutical manufacturers on one hand and prescribers, purchasers and formulary managers on the other.

Although there are a number of statutory exemptions and regulatory safe harbors protecting certain common activities from prosecution, the exemptions and safe harbors are drawn narrowly, and practices that involve remuneration intended to induce prescribing, purchasing, or recommending may be subject to scrutiny if they do not qualify for an

Table of Contents

exemption or safe harbor. Although we believe that we are in compliance, our practices may be determined to fail to meet all of the criteria for safe harbor protection from anti-kickback liability.

Federal false claims laws prohibit any person from knowingly presenting, or causing to be presented, a false claim for payment to the federal government, or knowingly making, or causing to be made, a false statement to get a false claim paid. Pharmaceutical companies have been prosecuted under these laws for a variety of alleged promotional and marketing activities, such as allegedly providing free product to customers with the expectation that the customers would bill federal programs for the product; reporting to pricing services inflated average wholesale prices that were then used by federal programs to set reimbursement rates; engaging in off-label promotion that caused claims to be submitted to Medicaid for non-covered off-label uses; and submitting inflated best price information to the Medicaid Rebate Program. The majority of states also have statutes or regulations similar to the federal anti-kickback law and false claims laws, which apply to items and services reimbursed under Medicaid and other state programs, or, in several states, apply regardless of the payor. Sanctions under these federal and state laws may include civil monetary penalties, exclusion of a manufacturer s products from reimbursement under government programs, criminal fines, and imprisonment. Because of the breadth of these laws and the narrowness of the safe harbors, it is possible that some of our business activities could be subject to challenge under one or more of such laws.

On April 25, 2007, we entered into a Settlement Agreement with the Justice Department, the Office of Inspector General of the Department of Health and Human Services (OIG) and the TRICARE Management Activity (collectively, the United States) and private complainants to settle all outstanding federal and state civil suits against us in connection with claims related to our alleged off-label marketing and promotion of LOPROX® and LOPROX® TS products to pediatricians during periods prior to our May 2004 disposition of our pediatric sales division (the Settlement Agreement). The settlement is neither an admission of liability by us nor a concession by the United States that its claims are not well founded. Pursuant to the Settlement Agreement, we agreed to pay approximately $10 million to settle the matter. Pursuant to the Settlement Agreement, the United States released us from the claims asserted by the United States and agreed to refrain from instituting action seeking exclusion from Medicare, Medicaid, the TRICARE Program and other federal health care programs for the alleged conduct. These releases relate solely to the allegations related to us and do not cover individuals. The Settlement Agreement also provides that the private complainants release us and our officers, directors and employees from the asserted claims, and we release the United States and the private complainants from asserted claims.

As part of the settlement, we have entered into a five-year Corporate Integrity Agreement (the CIA) with the OIG to resolve any potential administrative claims the OIG may have arising out of the government s investigation. The CIA acknowledges the existence of our comprehensive existing compliance program and provides for certain other compliance-related activities during the term of the CIA, including the maintenance of a compliance program that, among other things, is designed to ensure compliance with the CIA, federal health care programs and FDA requirements. Pursuant to the CIA, we are required to notify the OIG, in writing, of: (i) any ongoing government investigation or legal proceeding involving an allegation that we have committed a crime or has engaged in fraudulent activities; (ii) any other matter that a reasonable person would consider a probable violation of applicable criminal, civil, or administrative laws; (iii) any written report, correspondence, or communication to the FDA that materially discusses any unlawful or improper promotion of our products; and (iv) any change in location, sale, closing, purchase, or establishment of a new business unit or location related to items or services that may be reimbursed by Federal health care programs. We are also subject to periodic reporting and certification requirements attesting that the provisions of the CIA are being implemented and followed, as well as certain document and record retention mandates. We have hired a Chief Compliance Officer and created an enterprise-wide compliance function to administer our obligations under the CIA. Failure to comply under the CIA could result in substantial civil or criminal penalties and being excluded from government health care programs, which could materially reduce our sales and adversely affect our financial condition and results of operations.

On or about October 12, 2006, we and the United States Attorney s Office for the District of Kansas entered into a Nonprosecution Agreement wherein the government agreed not to prosecute us for any alleged criminal violations relating to the alleged off-label marketing and promotion of LOPROX® and LOPROX® TS. In connection with the government investigation, four employees, including Richard

45

Table of Contents

Havens, our former Executive Vice President, Sales and Marketing, separated from the Company as of April 1, 2008. In May 2008, five of our former employees, including Mr. Havens, plead or will plead guilty to misdemeanors in connection with their individual roles in the Company s alleged past off-label marketing and promotion of LOPROX® and LOPROX® TS. See Item 1 of Part II of this report, Legal Proceedings and Note 14, Contingencies, in the notes to the condensed consolidated financial statements listed under Item 1 of Part I of this report, Financial Statements, for information concerning our current litigation.

Our corporate compliance program cannot guarantee that we are in compliance with all potentially applicable U.S. federal and state regulations and all potentially applicable foreign regulations.

The development, manufacturing, distribution, pricing, sales, marketing and reimbursement of our products, together with our general operations, is subject to extensive federal and state regulation in the United States and in foreign countries. While we have developed and instituted a corporate compliance program based on what we believe to be current best practices, we cannot assure you that we or our employees are or will be in compliance with all potentially applicable U.S. federal and state regulations and/or laws or all potentially applicable foreign regulations and/or laws. If we fail to comply with any of these regulations and/or laws a range of actions could result, including, but not limited to, the failure to approve a product candidate, restrictions on our products or manufacturing processes, including withdrawal of our products from the market, significant fines, exclusion from government healthcare programs or other sanctions or litigation.

In addition, we have entered into a five-year CIA with the OIG. The CIA acknowledges the existence of our comprehensive existing compliance program and provides for certain other compliance-related activities during the term of the CIA, including the maintenance of a compliance program that, among other things, is designed to ensure compliance with the CIA, federal health care programs and FDA requirements. Pursuant to the CIA, we are required to notify the OIG, in writing, of: (i) any ongoing government investigation or legal proceeding involving an allegation that we have committed a crime or has engaged in fraudulent activities; (ii) any other matter that a reasonable person would consider a probable violation of applicable criminal, civil, or administrative laws; (iii) any written report, correspondence, or communication to the FDA that materially discusses any unlawful or improper promotion of our products; and (iv) any change in location, sale, closing, purchase, or establishment of a new business unit or location related to items or services that may be reimbursed by Federal health care programs. We are also subject to periodic reporting and certification requirements attesting that the provisions of the CIA are being implemented and followed, as well as certain document and record retention mandates. We have hired a Chief Compliance Officer and created an enterprise-wide compliance function to administer our obligations under the CIA. Failure to comply under the CIA could result in substantial civil or criminal penalties and being excluded from government health care programs, which could materially reduce our sales and adversely affect our financial condition and results of operations.

We depend on a limited number of customers, and if we lose any of them, our business could be harmed.

Our customers include some of the United States leading wholesale pharmaceutical distributors, such as Cardinal Health, McKesson, and major drug chains. We recently entered into distribution services agreements with McKesson and Cardinal. During 2007, McKesson and Cardinal accounted for 52.2% and 16.9%, respectively, of our net revenues. During 2006, McKesson and Cardinal accounted for 56.8% and 19.3%, respectively, of our net revenues. During the Transition Period, McKesson and Cardinal accounted for 54.9% and 18.9%, respectively, of our net revenues. During fiscal 2005, McKesson and Cardinal accounted for 51.2%, and 21.8%, respectively, of our net revenues. The loss of either of these customers accounts or a material reduction in their purchases could harm our business, financial condition or results of operations. McKesson is our sole distributor of our RESTYLANE® and PERLANE® products in the United States and Canada.

Table of Contents

We derive a majority of our sales from our primary products, and any factor adversely affecting sales of these products would harm our business, financial condition and results of operations.

We believe that the prescription volume of our primary prescription products, in particular, SOLODYN® and ZIANA®, and sales of our dermal aesthetic products, RESTYLANE® and PERLANE®, will continue to constitute a significant portion of our sales for the foreseeable future. Accordingly, any factor adversely affecting our sales related to these products, individually or collectively, could harm our business, financial condition and results of operations. On June 5, 2006, Allergan announced that the FDA had approved its Juvéderm™ dermal filler family of products. Allergan began marketing these products in January 2007. Other dermal filler products, such as Artefill®, Radiesse®, Sculptra® and Elevess™ have also recently been approved by the FDA. Patients may differentiate these products from RESTYLANE® and PERLANE® based on price, efficacy and/or duration, which may appeal to some patients. In addition, there are several dermal filler products under development and/or in the FDA pipeline for approval which claim to offer equivalent or greater facial aesthetic benefits to RESTYLANE® and PERLANE® and, if approved, the companies producing such products could charge less to doctors for their products. On January 15, 2008, we announced that IMPAX announced that IMPAX sent us a letter advising that IMPAX has filed an ANDA seeking FDA approval to market a generic version of SOLODYN® (minocycline HCl) extended-release capsules. IMPAX has not advised us as to the status of the FDA s review of its filing, or whether IMPAX has complied with recent FDA requirements for proving bioequivalence. Also on January 15, 2008, IMPAX filed a lawsuit against us in the United States District Court for the Northern District of California seeking a declaratory judgment that our U.S Patent No. 5,908,838 related to SOLODYN® is invalid and is not infringed by IMPAX s ANDA for a generic version of SOLODYN®. On April 16, 2008, the Court granted Medicis motion to dismiss the IMPAX complaint for lack of jurisdiction. It is not known whether IMPAX will file an appeal.

Sales related to our primary prescription products, including SOLODYN® and ZIANA®, and sales of our dermal restorative products, RESTYLANE® and PERLANE® could also be adversely affected by other factors, including:

- manufacturing or supply interruptions;
- the development of new competitive pharmaceuticals and technological advances to treat the conditions addressed by our primary products, including the introduction of new products into the marketplace;
- generic competition;
- marketing or pricing actions by one or more of our competitors;
- regulatory action by the FDA and other government regulatory agencies;
- importation of other dermal fillers;
- changes in the prescribing or procedural practices of dermatologists, plastic surgeons and/or podiatrists;
- changes in the reimbursement or substitution policies of third-party payors or retail pharmacies;
- product liability claims;
- the outcome of disputes relating to trademarks, patents, license agreements and other rights;
- changes in state and federal law that adversely affect our ability to market our products to dermatologists, plastic surgeons and/or podiatrists; and

restrictions on travel affecting the ability of our sales force to market to prescribing physicians and plastic surgeons in person.

Our continued growth depends upon our ability to develop new products.

We have internally developed potential pharmaceutical compounds and agents. We also have acquired the rights to certain potential compounds and agents in various stages of development. We currently have a variety of new products in various stages of research and development and are working on possible improvements, extensions and reformulations of some existing products. These research and

Table of Contents

development activities, as well as the clinical testing and regulatory approval process, which must be completed before commercial quantities of these developments can be sold, will require significant commitments of personnel and financial resources. We cannot assure you that we will be able to develop a product or technology in a timely manner, or at all. Delays in the research, development, testing or approval processes will cause a corresponding delay in revenue generation from those products. Regardless of whether they are ever released to the market, the expense of such processes will have already been incurred. For example, on January 30, 2008, we received a letter from the FDA stating that, upon a preliminary review of our BLA for the botulinum toxin type A, RELOXIN®, in aesthetics, the FDA has determined not to accept the BLA for filing because it is not sufficiently complete to permit a substantive review. While we are uncertain of the impact at this time, the FDA s determination not to accept the BLA may result in delays in the FDA s substantive response to the BLA. On March 17, 2008, we announced that the BLA had been re-submitted to the FDA.

We reevaluate our research and development efforts regularly to assess whether our efforts to develop a particular product or technology are progressing at a rate that justifies our continued expenditures. On the basis of these reevaluations, we have abandoned in the past, and may abandon in the future, our efforts on a particular product or technology. Products that we research or develop may not be successfully commercialized. If we fail to take a product or technology from the development stage to market on a timely basis, we may incur significant expenses without a near-term financial return.

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

There is also a risk that our products may not gain market acceptance among physicians, patients and the medical community generally. The degree of market acceptance of any medical device or other product that we develop will depend on a number of factors, including demonstrated clinical efficacy and safety, cost-effectiveness, potential advantages over alternative products, and our marketing and distribution capabilities. Physicians will not recommend our products until clinical data or other factors demonstrate their safety and efficacy compared to other competing products. Even if the clinical safety and efficacy of using our products is established, physicians may elect to not recommend using them for any number of other reasons, including whether our products best meet the particular needs of the individual patient.

Our operating results and financial condition may fluctuate.

Our operating results and financial condition may fluctuate from quarter to quarter and year to year for a number of reasons. The following events or occurrences, among others, could cause fluctuations in our financial performance from period to period:

- development of new competitive products or generics by others;
- the timing and receipt of FDA approvals or lack of approvals;
- changes in the amount we spend to develop, acquire or license new products, technologies or businesses;
- costs related to business development transactions;
- untimely contingent research and development payments under our third-party product development agreements;
- changes in the amount we spend to promote our products;

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

Table of Contents

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

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

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

manufacturing and supply interruptions, including failure to comply with manufacturing specifications;

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

the impact on our employees, customers, patients, manufacturers, suppliers, vendors, and other companies we do business with and the resulting impact on the results of operations associated with the possible mutation of the avian form of influenza from birds or other animal species to humans, current human morbidity, and mortality levels persist following such potential mutation;

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

lower than expected demand for our products;

our responses to price competition;

expenditures as a result of legal actions, including the defense of our patents and other intellectual property;

market acceptance of our products;

the impairment and write-down of goodwill or other intangible assets;

implementation of new or revised accounting or tax rules or policies;

disposition of primary products, technologies and other rights;

termination or expiration of, or the outcome of disputes relating to, trademarks, patents, license agreements and other rights;

increases in insurance rates for existing products and the cost of insurance for new products;

general economic and industry conditions, including changes in interest rates affecting returns on cash balances and investments that affect customer demand;

seasonality of demand for our products;

our level of research and development activities;

new accounting standards and/or changes to existing accounting standards that would have a material effect on our consolidated financial position, results of operations or cash flows;

costs and outcomes of any tax audits or any litigation involving intellectual property, customers or other issues; and

timing of revenue recognition related to licensing agreements and/or strategic collaborations.

As a result, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful, and these comparisons should not be relied upon as an indication of future performance. The above factors may cause our operating results to fluctuate and adversely affect our financial condition and results of operations.

Our investments in other companies and our collaborations with companies could adversely affect our results of operations and financial condition.

We have made substantial investments in companies and entered into significant collaborations with companies. We may use these and other methods to develop or commercialize products in the future. These arrangements typically involve other pharmaceutical companies as partners that may be competitors of ours in certain markets. In many instances, we will not control these companies or collaborations, and cannot assure you that these ventures will be profitable or that we will not lose any or all of our invested capital. If these investments and collaborations provide to unsuccessful, our results of operations could materially suffer.

Table of Contents

Our profitability is impacted by our continued participation in governmental pharmaceutical pricing programs.

In order for our products to receive reimbursement by state Medicaid programs, we must participate in the Medicaid drug rebate program. Participation in the program requires us to provide a rebate for each unit of our products that is reimbursed by Medicaid. Rebate amounts for our products are determined by a statutory formula that is based on prices defined by statute: average manufacturer price (AMP), which we must calculate for all products that are covered outpatient drugs under the Medicaid program, and best price, which we must calculate only for those of our covered outpatient drugs that are innovator products. We are required to report AMP and best price for each of our covered outpatient drugs to the government on a regular basis. In July 2007, the Centers for Medicare and Medicaid Services (CMS), the federal agency that is responsible for administering the Medicaid drug rebate program, issued a final rule that, among other things, clarifies how manufacturers must calculate both AMP and best price and implements new requirements under the Deficit Reduction Act of 2005 on the use of AMP to calculate federal upper limits on pharmacy reimbursement amounts under the Medicaid program. These upper limits are used to determine ceilings placed on the amounts that state Medicaid programs can pay for certain prescription drugs using federal dollars. We cannot predict the full impact of these changes, which became effective in part on January 1, 2007 and in part on October 1, 2007, on our business, nor can we predict whether there will be additional federal legislative or regulatory proposals to modify current Medicaid rebate rules.

To receive reimbursement under state Medicaid programs for our products, we also are required by federal law to provide discounts under other pharmaceutical pricing programs. For example, we are required to enter into a Federal Supply Schedule (FSS) contract with the Department of Veterans Affairs (VA) under which we must make our covered drugs available to the Big Four federal agencies the VA, the Department of Defense, the Public Health Service, and the Coast Guard at pricing that is capped pursuant to a statutory Federal ceiling price (FCP) formula set forth in the Veterans Health Care Act of 1992 (VHCA). The FCP is based on a weighted average wholesaler price known as the non-federal average manufacturer price, which manufacturers are required to report on a quarterly and annual basis to the VA. FSS contracts are federal procurement contracts that include standard government terms and conditions and separate pricing for each product. In addition to the Big Four agencies, all other federal agencies and some non-federal entities are authorized to access FSS contracts. FSS contractors are permitted to charge FSS purchasers other than the Big Four agencies negotiated pricing for covered drugs that is not capped by the VHCA formula; instead, such pricing is negotiated based on a mandatory disclosure of the contractor s commercial most favored customer pricing. Medicis chooses to offer one single FCP-based FSS contract price for each product to the Big Four agencies as well as all to other FSS purchasers. Medicis also offers products that are not VHCA covered drugs on its FSS contract at negotiated pricing. All items on FSS contracts are subject to a standard FSS contract clause that requires FSS contract price reductions under certain circumstances where pricing to an agreed tracking customer is reduced.

To receive reimbursement under state Medicaid programs for our products, we also are required by federal law to provide discounted purchase prices under the Public Health Service Drug Pricing Program to certain categories of entities defined by statute. The formula for determining the discounted purchase price is defined by statute and is based on the AMP and rebate amount for a particular product as calculated under the Medicaid drug rebate program, discussed above. To the extent that the statutory and regulatory definitions of AMP and the Medicaid rebate amount change as a result of the Deficit Reduction Act and final rule discussed above, these changes also could impact the discounted purchase prices that we are obligated to provide under this program. We cannot predict the full impact of these changes, which became effective in part on January 1, 2007 and in part on October 1, 2007, on our business, nor can we predict whether there will be additional federal legislative or regulatory proposals to modify current Medicaid rebate rules which then could impact this program as well.

Table of Contents

Our profitability may be impacted by our ongoing review of our prior reports under certain Federal pharmaceutical pricing programs.

Under the terms of our Medicaid drug rebate program agreement and our VA Federal Supply Schedule (FSS) contract and related pricing agreements required under the Veterans Health Care Act of 1992, we are required to accurately report our pharmaceutical pricing data, which is based, in part, on accurate classifications of our customers classes of trade. On May 1, 2007, and on May 15, 2007, we notified the U.S. Department of Health and Human Services and the Department of Veterans Affairs, respectively, that we may have misclassified certain of our customers classes of trade, which could affect the prices previously reported under the Medicaid drug rebate program and/or prices on our VA FSS contract. We have been reviewing this issue and have identified certain customer class of trade misclassifications. We are therefore undertaking a review and recalculation of our Non-Federal Average Manufacturer Prices (Non-FAMPs) and related Federal Ceiling Prices, Average Manufacturer Prices (AMPs), and Best Prices (BPs) for a period going back at least (3) years to determine the impact, if any, that reclassification of customers to appropriate classes of trade might have on these reported prices. In doing the recalculation, we will generally review the methodologies for computing the reported prices, the classification of products under the various programs, and any other potentially significant issues identified in the course of the review. We also are conducting a review of our administration of obligations under the Price Reductions Clause in our FSS contract with the VA. It is unclear whether any issue that may be identified during this review may result in any changes to our Medicaid rebate liability for prior quarters or to prices paid under the FSS, or any penalties, or whether any such changes or penalties would have a material impact on our business, financial condition, results of operations or cash flows.

We will be unable to meet our anticipated development and commercialization timelines if clinical trials for our products are unsuccessful, delayed, or additional information is required by the FDA.

The production and marketing of our products and our ongoing research and development, pre-clinical testing and clinical trials activities are subject to extensive regulation and review by numerous governmental authorities. Before obtaining regulatory approvals for the commercial sale of any products, we and/or our partners must demonstrate through pre-clinical testing and clinical trials that our products are safe and effective for use in humans. Conducting clinical trials is a lengthy, time-consuming and expensive process. In addition to testing and approval procedures, extensive regulations also govern marketing, manufacturing, distribution, labeling and record-keeping procedures.

Completion of clinical trials may take several years or more. Our commencement and rate of completion of clinical trials may be delayed by many factors, including:

- lack of efficacy during the clinical trials;
- unforeseen safety issues;
- slower than expected patient recruitment;
- failure of Medicis, investigators, or other contractors to strictly adhere to federal regulations governing the conduct and data collection procedures involved in clinical trials;
- development of issues that might delay or impede performance by a contractor;
- errors in clinical documentation or at the clinical locations;
- non-acceptance by the FDA of our NDAs, ANDAs or BLAs. For example, on January 30, 2008, we received a letter from the FDA stating that, upon a preliminary review of our BLA for the botulinum toxin type A, RELOXIN®, in aesthetics, the FDA has determined not to accept the BLA for filing because it is not sufficiently complete to permit a substantive review. While we are uncertain of the impact at this time, the FDA s determination not to accept the BLA may result in delays in the FDA s substantive

Table of Contents

response to the BLA. On March 17, 2008, we announced that the BLA had been re-submitted to the FDA;

government or regulatory delays; and

unanticipated requests from the FDA for new or additional information.

The results from pre-clinical testing and early clinical trials are often not predictive of results obtained in later clinical trials. A number of new products have shown promising results in clinical trials, but subsequently failed to establish sufficient safety and efficacy data to obtain necessary regulatory approvals. Data obtained from pre-clinical and clinical activities are susceptible to varying interpretations, which may delay, limit or prevent regulatory approval. In addition, regulatory delays or rejections may be encountered as a result of many factors, including perceived defects in the design of the clinical trials and changes in regulatory policy during the period of product development. Any delays in, or termination of, our clinical trials could materially and adversely affect our development and commercialization timelines, which could adversely affect our financial condition, results of operations and cash flows.

Downturns in general economic conditions may adversely affect our financial condition, results of operations and cash flows.

Our business, including our dermal restorative and branded prescription products, may be adversely affected by downturns in general economic conditions. Economic conditions such as employment levels, business conditions, interest rates, energy and fuel costs, consumer confidence and tax rates could change consumer purchasing habits or reduce personal discretionary spending. A reduction in consumer spending may have an adverse impact on our financial condition, results of operations and cash flows.

The current condition of the credit markets may not allow us to secure financing for potential future activities on satisfactory terms, or at all.

Our existing cash and short-term investments are available for dividends, strategic investments, acquisitions of companies or products complimentary to our business, the repayment of outstanding indebtedness, repurchases of our outstanding securities and other potential large-scale needs. While we believe existing cash and short-term investments, together with funds generated from operations, should be sufficient to meet operating requirements for the foreseeable future, we may also 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. As a result of recent subprime loan losses and write-downs, as well as other economic trends in the credit market industry, we may not be able to secure additional financing for future activities on satisfactory terms, or at all, which may adversely affect our financial condition and results of operations.

Negative conditions in the credit markets may impair the liquidity of a portion of our short-term and long-term investments.

Our short-term and long-term investments consist of corporate and various government agency and municipal debt securities and auction rate floating securities. As of March 31, 2008, our investments included $44.1 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. The recent negative conditions in the credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008, we were 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 we could be required to hold them until they are redeemed by the holder at

Table of Contents

maturity. We may not be able to make the securities liquid until a future auction on these investments is successful.

If Q-Med is unable to protect its intellectual property and proprietary rights with respect to our dermal filler products, our business could suffer.

RESTYLANE®, PERLANE®, RESTYLANE FINE LINES™ and SubQ™ currently have patent protection in the United States until 2015, and the exclusivity period of the license granted to us by Q-Med will terminate on the later of (i) the expiration of the last patent covering the products or (ii) upon the licensed know-how becoming publicly known. If the validity or enforceability of these patents is successfully challenged, the cost to us could be significant and our business may be harmed. For example, if any such challenges are successful, Q-Med may be unable to supply products to us. As a result, we may be unable to market, distribute and commercialize the products or it may no longer be profitable for us to do so.

We may not be able to collect all scheduled license payments from BioMarin.

As part of our asset purchase agreement, license agreement and securities purchase agreement with BioMarin Pharmaceutical Inc. (BioMarin) discussed in Note 10 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007, BioMarin will make license payments to us of $1.75 million per quarter for the quarter beginning in April 2008 and $1.5 million per quarter for the subsequent four quarters beginning in July 2008. While we did receive all scheduled quarterly license payments during the first quarter of 2008, 2007, 2006, the Transition Period and fiscal 2005, we cannot give any assurances as to BioMarin s continuing ability to make these payments to us. Currently, our revenue recognition of these payments is on a cash basis. In addition, while we expect BioMarin to make the final payment of $70.6 million to us in 2009 for the purchase of all of the outstanding shares of Ascent Pediatrics, we cannot give any assurances as to BioMarin s ability to make this payment. Should BioMarin be unable or unwilling to make the required payments, we may be required to record an impairment of the related Ascent goodwill. If BioMarin defaults on its obligations to make the required payments, we may be forced to incur indebtedness or otherwise reallocate our financial resources to cover the loss of these expected cash payments.

We depend upon our key personnel and our ability to attract, train, and retain employees.

Our success depends significantly on the continued individual and collective contributions of our senior management team, and Jonah Shacknai, our Chairman and Chief Executive Officer, in particular. While we have entered into employment agreements with many members of our senior management team, the loss of the services of any member of our senior management for any reason or the inability to hire and retain experienced management personnel could adversely affect our ability to execute our business plan and harm our operating results. In addition, our future success depends on our ability to hire, train and retain skilled employees. Competition for these employees is intense.

We may acquire (whether by acquisition, license or otherwise) technologies, products and companies in the future and these acquisitions could disrupt our business and harm our financial condition and results of operations. In addition, we may not obtain the benefits that the acquisitions were intended to create.

As part of our business strategy, we regularly consider and, as appropriate, make acquisitions (whether by acquisition, license or otherwise) of technologies, products and companies that we believe are complementary to our business. Acquisitions typically entail many risks and could result in difficulties in integrating the operations, personnel, technologies, products and companies acquired, and may result in significant charges to earnings. If we are unable to successfully integrate our acquisitions with our existing business, or we otherwise make an acquisition that does not result in the benefits that we anticipated, our business, results of operations, financial condition and cash flows could be materially and adversely affected, which would adversely affect our ability to develop and introduce new products and the market price of our stock. In addition, in connection with acquisitions, we could experience disruption in our

Table of Contents

business or employee base, or key employees of companies that we acquire may seek employment elsewhere, including with our competitors. Furthermore, the products of companies we acquire may overlap with our products or those of our customers, creating conflicts with existing relationships or with other commitments that are detrimental to the combined businesses.

We may not be able to identify and acquire products, technologies and businesses on acceptable terms, if at all, which may constrain our growth.

Our strategy for continued growth includes the acquisition of products, technologies and businesses. These acquisitions could involve acquiring other pharmaceutical companies assets, products or technologies. In addition, we may seek to obtain licenses or other rights to develop, manufacture and distribute products. We cannot be certain that we will be able to identify suitable acquisition or licensing candidates, if they will be accretive in the near future, or if any will be available on acceptable terms. Other pharmaceutical companies, with greater financial, marketing and sales resources than we have, are also attempting to grow through similar acquisition and licensing strategies. Because of their greater resources, our competitors may be able to offer better terms for an acquisition or license than we can offer, or they may be able to demonstrate a greater ability to market licensed products. In addition, even if we identify potential acquisitions and enter into definitive agreements relating to such acquisitions, we may not be able to consummate planned acquisitions on the terms originally agreed upon or at all. For example, on March 20, 2005, we entered into an agreement and plan of merger with Inamed, pursuant to which we agreed to acquire Inamed. On December 13, 2005, we entered into a merger termination agreement with Inamed following Allergan Inc. s exchange offer for all outstanding shares of Inamed, which was commenced on November 21, 2005.

Our success depends on our ability to manage our growth.

We have experienced a period of rapid growth from both acquisitions and internal expansion of our operations. This growth has placed significant demands on our human and financial resources. We must continue to improve our operational, financial and management information controls and systems and effectively motivate, train and manage our employees to properly manage this growth. If we do not manage this growth effectively, maintain the quality of our products despite the demands on our resources and retain key personnel, our business could be harmed.

Implementation of our new enterprise resource planning system could cause business interruptions and negatively affect our profitability and cash flows.

During 2007, we began developing and implementing a new enterprise resource planning (ERP) system to integrate and improve the financial and operational aspects of our business. A significant portion our new ERP system began to be utilized on January 1, 2008. The design and implementation of an ERP system, which will continue in 2008, involves risks such as cost overruns, project delays and business interruption. A significant amount of our resources have been committed to the ERP project, and we may experience challenges in designing and implementing the new ERP system that could adversely affect our operations and our ability to timely and accurately process and report key components of our financial position. If we experience a material business interruption as a result of our design and implementation of our new ERP system, it could have a material adverse effect on our business, results of operations and cash flows.

The consolidation of drug wholesalers could increase competition and pricing pressures throughout the pharmaceutical industry.

We sell our pharmaceutical products primarily through major wholesalers. These customers comprise a significant part of the distribution network for pharmaceutical products in the United States. This distribution network is continuing to undergo significant consolidation marked by mergers and acquisitions. As a result, a smaller number of large wholesale distributors control a significant share of the market. In addition, the number of independent drug stores and small chains has decreased as retail

Table of Contents

consolidation has occurred. Further consolidation among, or any financial difficulties of, distributors or retailers could result in the combination or elimination of warehouses which may result in product returns to us, cause a reduction in the inventory levels of distributors and retailers, result in reductions in purchases of our products or increase competitive and pricing pressures on pharmaceutical manufacturers, any of which could harm our business, financial condition and results of operations.

We rely on others to manufacture our products.

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

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

In addition, we rely on outside manufacturers to provide us with an adequate and reliable supply of our products on a timely basis, and in accordance with good manufacturing standards and applicable product specifications. As a result, we are subject to and have no control over delays and quality control lapses that our third-party manufacturers and suppliers may suffer. For example, in early May 2008, we became aware that our third-party manufacturer and supplier of SOLODYN® mistakenly filled at least one bottle labeled as SOLODYN® with a different pharmaceutical product. As a result of this occurrence, we initiated a voluntary recall of the two affected lots, each of which was shipped subsequent to March 31, 2008, and we may be subject to claims, fines or other penalties.

Loss of a supplier or any difficulties that arise in the supply chain could significantly affect our inventories and supply of products available for sale. We do not have alternative sources of supply for all of our products. If a primary supplier of any of our primary products is unable to fulfill our requirements for any reason, it could reduce our sales, margins and market share, as well as harm our overall business and financial results. If we are unable to supply sufficient amounts of our products on a timely basis, our revenues and market share could decrease and, correspondingly, our profitability could decrease.

Under several exclusive supply agreements, with certain exceptions, we must purchase most of our product supply from specific manufacturers. If any of these exclusive manufacturer or supplier relationships were terminated, we would be forced to find a replacement manufacturer or supplier. The FDA requires that all manufacturers used by pharmaceutical companies comply with the FDA s regulations, including the cGMP regulations applicable to manufacturing processes. The cGMP validation of a new facility and the approval of that manufacturer for a new drug product may take a year or more before manufacture can begin at the facility. Delays in obtaining FDA validation of a replacement manufacturing facility could cause an interruption in the supply of our products. Although we have business interruption insurance to assist in covering the loss of income for products where we do not have a secondary manufacturer, which may mitigate the harm to us from the interruption of the manufacturing of our largest selling products caused by certain events, the loss of a manufacturer could still cause a reduction in our sales, margins and market share, as well as harm our overall business and financial results.

We and our third-party manufacturers rely on a limited number of suppliers of the raw materials of our products. A disruption in supply of raw material would be disruptive to our inventory supply.

We and the manufacturers of our products rely on suppliers of raw materials used in the production of our products. Some of these materials are available from only one source and others may become available from only one source. We try to maintain inventory levels that are no greater than necessary to meet our current projections, which could have the affect of exacerbating supply problems. Any interruption in the supply of finished products could hinder our ability to timely distribute finished products. If we are unable to obtain adequate product supplies to satisfy our customers orders, we may lose those orders and our customers may cancel other orders and stock and sell competing products. This, in turn, could cause a loss of our market share and reduce our revenues. In addition, any disruption in the supply of raw materials or an increase in the cost of raw materials to our manufacturers could have a

significant effect on their ability to supply us with our products, which would adversely affect our financial condition and results of operations.

We could experience difficulties in obtaining supplies of RESTYLANE®, PERLANE®, RESTYLANE FINE LINES™ and SubQ™.

Table of Contents

The manufacturing process to create bulk non-animal stabilized hyaluronic acid necessary to produce RESTYLANE®, PERLANE®, RESTYLANE FINE LINES™ and SubQ™ products is technically complex and requires significant lead-time. Any failure by us to accurately forecast demand for finished product could result in an interruption in the supply of RESTYLANE®, PERLANE®, RESTYLANE FINE LINES™ and SubQ™ products and a resulting decrease in sales of the products.

We depend exclusively on Q-Med for our supply of RESTYLANE®, PERLANE®, RESTYLANE FINE LINES™ and SubQ™ products. There are currently no alternative suppliers of these products. Q-Med has committed to supply RESTYLANE® to us under a long-term license that is subject to customary conditions and our delivery of specified milestone payments. Q-Med manufactures RESTYLANE®, PERLANE®, RESTYLANE FINE LINES™ and SubQ™ at its facility in Uppsala, Sweden. We cannot be certain that Q-Med will be able to meet our current or future supply requirements. Any impairment of Q-Med s manufacturing capacities could significantly affect our inventories and our supply of products available for sale, which would materially and adversely affect our results of operations.

Supply interruptions may disrupt our inventory levels and the availability of our products.

Numerous factors could cause interruptions in the supply of our finished products, including:

timing, scheduling and prioritization of production by our contract manufacturers;

labor interruptions;

changes in our sources for manufacturing;

the timing and delivery of domestic and international shipments;

our failure to locate and obtain replacement manufacturers as needed on a timely basis;

conditions affecting the cost and availability of raw materials; and

hurricanes and other natural disasters.

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 may result in excessive inventory production and underestimates may result in inadequate supply of our products in channels of distribution.

We sell our products primarily to major wholesalers and retail pharmacy chains. Approximately 65-75% of our gross revenues are typically derived from two major drug wholesale concerns. We have recently entered into 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 supplied by our major wholesalers. We rely wholly upon our wholesale and drug chain customers to effect the distribution allocation of substantially all of our products.

We periodically offer promotions to wholesale and 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 drugstore and wholesale customers. We believe such availability reduces the probability of local and regional product substitutions, shortages and backorders, which could result in lost sales. We

Table of Contents

expect to continue providing favorable terms to wholesale and retail drug chain customers as may be necessary to ensure the fullest possible distribution of our branded products within the pharmaceutical chain of commerce.

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 in product inventory in the distribution channel. Any decision made by management to reduce wholesale inventory levels will decrease our product revenue.

Fluctuations in demand for our products create inventory maintenance uncertainties.

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. 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 provisions. 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 selectively outsource certain non-sales and non-marketing services, and cannot assure you that we will be able to obtain adequate supplies of such services on acceptable terms.

To enable us to focus on our core marketing and sales activities, we selectively outsource certain non-sales and non-marketing functions, such as laboratory research, manufacturing and warehousing. As we expand our activities, we expect to expend additional financial resources in these areas. We typically do not enter into long-term manufacturing contracts with third party manufacturers. Whether or not such contracts exist, we cannot assure you that we will be able to obtain adequate supplies of such services or products in a timely fashion, on acceptable terms, or at all.

Importation of products from Canada and other countries into the United States may lower the prices we receive for our products.

Our products are subject to competition from lower priced versions of our products and competing products from Canada and other countries where government price controls or other market dynamics result in lower prices. The ability of patients and other customers to obtain these lower priced imports has grown significantly as a result of the Internet, an expansion of pharmacies in Canada and elsewhere targeted to American purchasers, the increase in United States-based businesses affiliated with Canadian pharmacies marketing to American purchasers, and other factors. Most of these foreign imports are illegal under current United States law. However, the volume of imports continues to rise due to the limited enforcement resources of the FDA and the United States Customs Service, and there is increased political pressure to permit the imports as a mechanism for expanding access to lower priced medicines.

In December 2003, Congress enacted the Medicare Prescription Drug, Improvement and Modernization Act of 2003. This law contains provisions that may change United States import laws and expand consumers ability to import lower priced versions of our and competing products from Canada, where there are government price controls. These changes to United States import laws will not take effect unless and until the Secretary of Health and Human Services certifies that the changes will lead to substantial savings for consumers and will not create a public health safety issue. The former Secretary of Health and Human Services did not make such a certification. However, it is possible that the current Secretary or a subsequent Secretary could make the certification in the future. As directed by Congress, a task force on drug importation recently conducted a comprehensive study regarding the circumstances under which drug importation could be safely conducted and the consequences of importation on the health, medical costs and development of new medicines for United States consumers. The task force issued its report in December 2004, finding that there are significant safety and economic issues that must

Table of Contents

be addressed before importation of prescription drugs is permitted, and the current Secretary has not yet announced any plans to make the required certification. In addition, federal legislative proposals have been made to implement the changes to the United States import laws without any certification, and to broaden permissible imports in other ways. Even if the changes to the United States import laws do not take effect, and other changes are not enacted, imports from Canada and elsewhere may continue to increase due to market and political forces, and the limited enforcement resources of the FDA, the United States Customs Service and other government agencies.

The importation of foreign products adversely affects our profitability in the United States. This impact could become more significant in the future, and the impact could be even greater if there is a further change in the law or if state or local governments take further steps to facilitate the importation of products from abroad.

If we become subject to product liability claims, our earnings and financial condition could suffer.

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

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

If we suffer negative publicity concerning the safety of our products, our sales may be harmed and we may be forced to withdraw products.

Physicians and potential patients may have a number of concerns about the safety of our products, whether or not such concerns have a basis in generally accepted science or peer-reviewed scientific research. Negative publicity, whether accurate or inaccurate, concerning our products could reduce market or governmental acceptance of our products and could result in decreased product demand or product withdrawal. In addition, significant negative publicity could result in an increased number of product liability claims, whether or not these claims are supported by applicable law.

Rising insurance costs could negatively impact profitability.

The cost of insurance, including workers compensation, product liability and general liability insurance, have risen significantly in recent years and may increase in the future. In response, we may increase deductibles and/or decrease certain coverages to mitigate these costs. These increases, and our increased risk due to increased deductibles and reduced coverages, could have a negative impact on our results of operations, financial condition and cash flows.

RESTYLANE® and PERLANE® are consumer products and as such, are susceptible to changes in popular trends and applicable laws, which could adversely affect sales or product margins of RESTYLANE® and PERLANE®.

RESTYLANE® and PERLANE® are consumer products. If we fail to anticipate, identify or react to competitive products or if consumer preferences in the cosmetic marketplace shift to other treatments for the treatment of fine lines, wrinkles and deep facial folds, we may experience a decline in demand for RESTYLANE® and PERLANE®. In addition, the popular media has at times in the past produced, and may continue in the future to produce, negative reports regarding the efficacy, safety or side effects of

Table of Contents

facial aesthetic products. Consumer perceptions of RESTYLANE® and PERLANE® may be negatively impacted by these reports and other reasons.

Demand for RESTYLANE® and PERLANE® may be materially adversely affected by changing economic conditions. Generally, the costs of cosmetic procedures are borne by individuals without reimbursement from their medical insurance providers or government programs. Individuals may be less willing to incur the costs of these procedures in weak or uncertain economic environments, and demand for RESTYLANE® and PERLANE® could be adversely affected.

We may not be able to repurchase the Old Notes and New Notes when required.

In June 2002, we sold Contingent Convertible Senior Notes, due in 2032 (the Old Notes), in the amount of $400.0 million. In August 2003, we exchanged approximately $230.8 million in principal of these Old Notes for approximately $283.9 million of our Contingent Convertible Senior Notes due in 2033 (the New Notes).

On June 4, 2012 and 2017 or upon the occurrence of a change in control, holders of the remaining Old Notes may require us to offer to repurchase their Old Notes for cash. On June 4, 2008, 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. If a significant portion of the holders of the New Notes require us to repurchase their New Notes on June 4, 2008, we may not have sufficient funds on June 4, 2008 or at the time of any such events to make the required repurchases. If all of the New Notes are put back to us on June 4, 2008, we would be required to pay $283.9 million in outstanding principal, plus outstanding accrued interest. We would also be required to pay an accumulated deferred tax liability related to the New Notes. The deferred tax liability related to the New Notes as of March 31, 2008 was $33.2 million.

The source of funds for any repurchase required as a result of any such events will be our available cash or cash generated from operating activities or other sources, including borrowings, sales of assets, sales of equity or funds provided by a new controlling entity. We cannot assure you, however, that sufficient funds will be available at the time of any such events to make any required repurchases of the Notes tendered. If sufficient funds are not available to repurchase the Notes, we may be forced to incur other indebtedness or otherwise reallocate our financial resources. Furthermore, the use of available cash to fund the repurchase of the Old Notes or New Notes may impair our ability to obtain additional financing in the future.

Our publicly-filed reports are reviewed by the SEC from time to time and any significant changes required as a result of any such review may result in material liability to us, and have a material adverse impact on the trading price of our common stock.

The reports of publicly-traded companies are subject to review by the SEC from time to time for the purpose of assisting companies in complying with applicable disclosure requirements and to enhance the overall effectiveness of companies public filings, and comprehensive reviews of such reports are now required at least every three years under the Sarbanes-Oxley Act of 2002. SEC reviews may be initiated at any time. While we believe that our previously filed SEC reports comply, and we intend that all future reports will comply in all material respects with the published rules and regulations of the SEC, we could be required to modify or reformulate information contained in prior filings as a result of an SEC review. Any modification or reformulation of information contained in such reports could be significant and result in material liability to us and have a material adverse impact on the trading price of our common stock.

Table of Contents

Unanticipated changes in our tax rates or exposure to additional income tax liabilities could affect our profitability.

We are subject to income taxes in both the U.S. and other foreign jurisdictions. Our effective tax rate could be adversely affected by changes in the mix of earnings in countries with different statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in or interpretations of tax laws including pending tax law changes (such as the research and development credit and the deductibility of executive compensation), changes in our manufacturing activities and changes in our future levels of research and development spending. In addition, we are subject to the periodic examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these periodic examinations will not have an adverse effect on our provision for income taxes and estimated income tax liabilities.

Risks Related to Our Industry

The growth of managed care organizations, other third-party reimbursement policies, state regulatory agencies and retailer fulfillment policies may harm our pricing, which may reduce our market share and margins.

Our operating results and business success depend in large part on the availability of adequate third-party payor reimbursement to patients for our prescription-brand products. These third-party payors include governmental entities such as Medicaid, private health insurers and managed care organizations. Because of the size of the patient population covered by managed care organizations, marketing of prescription drugs to them and the pharmacy benefit managers that serve many of these organizations has become important to our business.

The trend toward managed healthcare in the United States and the growth of managed care organizations could significantly influence the purchase of pharmaceutical products, resulting in lower prices and a reduction in product demand. Managed care organizations and other third party payors try to negotiate the pricing of medical services and products to control their costs. Managed care organizations and pharmacy benefit managers typically develop formularies to reduce their cost for medications. Formularies can be based on the prices and therapeutic benefits of the available products. Due to their lower costs, generic products are often favored. The breadth of the products covered by formularies varies considerably from one managed care organization to another, and many formularies include alternative and competitive products for treatment of particular medical conditions. Exclusion of a product from a formulary can lead to its sharply reduced usage in the managed care organization patient population. Payment or reimbursement of only a portion of the cost of our prescription products could make our products less attractive, from a net-cost perspective, to patients, suppliers and prescribing physicians. We cannot be certain that the reimbursement policies of these entities will be adequate for our pharmaceutical products to compete on a price basis. If our products are not included within an adequate number of formularies or adequate reimbursement levels are not provided, or if those policies increasingly favor generic products, our market share and gross margins could be harmed, as could our business, financial condition, results of operations and cash flows.

In addition, healthcare reform could affect our ability to sell our products and may have a material adverse effect on our business, results of operations, financial condition and cash flows.

Some of our products are not of a type generally eligible for reimbursement. It is possible that products manufactured by others could address the same effects as our products and be subject to reimbursement. If this were the case, some of our products may be unable to compete on a price basis. In addition, decisions by state regulatory agencies, including state pharmacy boards, and/or retail pharmacies may require substitution of generic for branded products, may prefer competitors products over our own, and may impair our pricing and thereby constrain our market share and growth.

Table of Contents

Managed care initiatives to control costs have influenced primary-care physicians to refer fewer patients to dermatologists and other specialists. Further reductions in these referrals could reduce the size of our potential market, and harm our business, financial condition, results of operations and cash flows.

We are subject to extensive governmental regulation.

Pharmaceutical companies are subject to significant regulation by a number of national, state and local governments and agencies. The FDA administers requirements covering testing, manufacturing, safety, effectiveness, labeling, storage, record keeping, approval, sampling, advertising and promotion of our products. Several states have also instituted laws and regulations covering some of these same areas. In addition, the FTC and state and local authorities regulate the advertising of over-the-counter drugs and cosmetics. Failure to comply with applicable regulatory requirements could, among other things, result in:

fines;

changes to advertising;

suspensions of regulatory approvals of products;

product withdrawals and recalls;

delays in product distribution, marketing and sale; and

civil or criminal sanctions.

For example, in early May 2008, we became aware that our third-party manufacturer and supplier of SOLODYN® mistakenly filled at least one bottle labeled as SOLODYN® with a different pharmaceutical product. As a result of this occurrence, we initiated a voluntary recall of the two affected lots, each of which was shipped subsequent to March 31, 2008, and we may be subject to claims, fines or other penalties.

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

Before marketing any drug that is considered a new drug by the FDA, the FDA must provide its approval of the product. All products which are considered drugs which are not new drugs and that generally are recognized by the FDA as safe and effective for use do not require the FDA s approval. We believe that some of our products, as they are promoted and intended for use, are exempt from treatment as new drugs and are not subject to approval by the FDA. The FDA, however, could take a contrary position, and we could be required to seek FDA approval of those products and the marketing of those products. We could also be required to withdraw those products from the market. For example, in the August 29, 2006 Federal Register, the FDA issued a notice of proposed rulemaking to categorically establish that over-the-counter skin bleaching drug products are not generally recognized as safe and effective and are misbranded. If the proposed rule is adopted, all manufacturers of skin bleaching products would be required to remove their products from the market and obtain FDA approval prior to re-entering the U.S. market. The FDA has issued a Guidance document entitled Marketed Unapproved Drugs Compliance Policy Guide. During a public workshop on January 9, 2007 concerning this Guidance, the FDA was reported to have stated the intention to accelerate its evaluation of such products. ESOTERICA® is an over-the-counter product line that we sell that contains bleaching products that would be regulated by the proposed rule and if that occurs we do not currently intend to invest in obtaining an approved NDA for this product line. This product accounted for approximately $2.2 million in net revenues during 2007.

Sales representative activities may also be subject to the Voluntary Compliance Guidance issued for pharmaceutical manufacturers by the Office of Inspector General (OIG) of the Department of Health and Human

Services, as well as state laws and regulations. We have established compliance program policies and training programs for our sales force, which we believe are appropriate. The OIG and/or state law enforcement entities, however, could take a contrary position, and we could be required to modify our sales representative activities. See Item 1 of Part II of this report, Legal Proceedings and Note 14, Contingencies, in the notes to the condensed consolidated financial statements listed under Item 1 of Part I of this report, Financial Statements, for information concerning our current litigation.

Table of Contents

We face significant competition within our industry.

The pharmaceutical and dermal aesthetics industries are highly competitive. Competition in our industry occurs on a variety of fronts, including:

developing and bringing new products to market before others;

developing new technologies to improve existing products;

developing new products to provide the same benefits as existing products at less cost; and

developing new products to provide benefits superior to those of existing products.

The intensely competitive environment requires an ongoing, extensive search for technological innovations and the ability to market products effectively. Consequently, we must continue to develop and introduce products in a timely and cost-efficient manner to effectively compete in the marketplace and maintain our revenue and gross margins.

Our competitors vary depending upon product categories. Many of our competitors are large, well-established companies in the fields of pharmaceuticals, chemicals, cosmetics and health care. Among our largest competitors are Allergan, Galderma, Johnson & Johnson, Sanofi-Aventis, Stiefel Laboratories, Warner Chilcott and others.

Many of these companies have greater resources than we do to devote to marketing, sales, research and development and acquisitions. As a result, they have a greater ability to undertake more extensive research and development, marketing and pricing policy programs. It is possible that our competitors may develop new or improved products to treat the same conditions as our products or make technological advances reducing their cost of production so that they may engage in price competition through aggressive pricing policies to secure a greater market share to our detriment. These competitors also may develop products that make our current or future products obsolete. Any of these events could significantly harm our business, financial condition and results of operations, including reducing our market share, gross margins, and cash flows.

We sell and distribute prescription brands, medical devices and over-the-counter products. Each of these products competes with products produced by others to treat the same conditions. Several of our prescription products compete with generic pharmaceuticals, which claim to offer equivalent benefit at a lower cost. In some cases, insurers and other health care payment organizations try to encourage the use of these less expensive generic brands through their prescription benefits coverage and reimbursement policies. These organizations may make the generic alternative more attractive to the patient by providing different amounts of reimbursement so that the net cost of the generic product to the patient is less than the net cost of our prescription brand product. Aggressive pricing policies by our generic product competitors and the prescription benefits policies of third party payors could cause us to lose market share or force us to reduce our gross margins in response.

There are several dermal filler products under development and/or in the FDA pipeline for approval, including products from Johnson & Johnson and Mentor, which claim to offer equivalent or greater facial aesthetic benefits to RESTYLANE® and, if approved, the companies producing such products could charge less to doctors for their products.

Table of Contents

Item 6. Exhibits

Exhibit 10.1*	Consulting and Services Agreement, dated as of April 2, 2008, between the Company and Richard J. Havens
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

* Incorporated by reference to the Company s Current Report on File 8-K filed with the SEC on April 1, 2008

\+ Filed herewith

Table of Contents

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 12, 2008

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

Date: May 12, 2008

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

Table of Contents

INDEX TO EXHIBITS

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