MEDICIS PHARMACEUTICAL CORP
Form 10-KT
March 16, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/T

o **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended .

or

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

For the transition period from July 1, 2005 to December 31, 2005

Commission file number 0-18443
MEDICIS PHARMACEUTICAL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**52-1574808**
(State of other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
8125 North Hayden Road, Scottsdale, Arizona	**85258-2463**
(Address of principal executive office)	*(Zip Code)*

Registrant s telephone number, including area code:
(602) 808-8800
Securities registered pursuant to Section 12(b) of the Act: Class A common stock, $0.014 par value

New York Stock Exchange	Preference Share Purchase Rights
(Name of each exchange on which registered)	*(Title of each Class)*

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 Noo

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information

statements incorporated by reference in Part III of this Form or any amendment to this Form 10-K/ T o.

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the voting stock held on December 31, 2005 by non-affiliates of the registrant was $1,225,975,222 based on the closing price of $32.05 per share as reported on the New York Stock Exchange on December 30, 2005, the last business day of the registrant s most recently completed second fiscal quarter (calculated by excluding all shares held by executive officers, directors and holders known to the registrant of five percent or more of the voting power of the registrant s common stock, without conceding that such persons are affiliates of the registrant for purposes of the federal securities laws). As of March 10, 2006, there were 54,427,972, outstanding shares of Class A common stock.

Documents incorporated by reference:

Portions of the Proxy Statement for the registrant s 2006 Annual Meeting of Shareholders (the Proxy Statement) are incorporated herein by reference in Part III of this Form 10-K/ T to the extent stated herein.

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. *Business*

Change in Fiscal Year

Effective December 31, 2005, Medicis Pharmaceutical Corporation (Medicis , the Company , or as used in the context of we , us or our) changed its fiscal year end from June 30 to December 31. This change was made to align our fiscal year end with other companies within our industry. This Form 10-K/ T is intended to cover the transition report for the period July 1, 2005 through December 31, 2005 (the Transition Period). Subsequent to this, our Form 10-K will cover the calendar year January 1 to December 31. We refer to the period beginning July 1, 2004 and ending June 30, 2005 as fiscal 2005 , the period beginning July 1, 2003 and ending June 30, 2004 as fiscal 2004 and the period beginning July 1, 2002 and ending June 30, 2003 as fiscal 2003 .

The Company

Medicis Pharmaceutical Corporation, together with its wholly owned subsidiaries, is a leading independent specialty pharmaceutical company focusing primarily on helping patients attain a healthy and youthful appearance and self-image through the development and marketing of products for the treatment of dermatological and aesthetic conditions in the United States and Canada, and podiatric conditions in the United States. We believe that annual U.S. pharmaceutical sales in the dermatological market exceed $5 billion. According to the American Society for Aesthetic Plastic Surgery, a national not-for-profit organization for education and research in cosmetic plastic surgery, nearly 11.5 million surgical and non-surgical cosmetic procedures were performed in the United States during 2005, including approximately 9.3 million non-surgical cosmetic procedures.

We have built our business by executing a four-part growth strategy: promoting existing core 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 relationships of trust and confidence with the high prescribing dermatologists and podiatrists and the leading plastic surgeons in the United States.

We offer a broad range of products addressing various conditions including acne, fungal infections, rosacea, hyperpigmentation, photoaging, psoriasis, eczema, skin and skin-structure infections, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). We currently offer 15 branded products. Our core brands are DYNACIN® (minocycline HCI), LOPROX® (ciclopirox), OMNICEF® (cefdinir), PLEXION® (sodium sulfacetamide/sulfur), RESTYLANE® (hyaluronic acid), TRIAZ® (benzoyl peroxide), and VANOS™ (fluocinonide) Cream 0.1%. All of our core brands enjoy branded market leadership in the segments in which they compete. Because of the significance of these brands to our business, we concentrate our sales and marketing efforts in promoting them to physicians in our target markets. We also sell a number of other products that are considered less critical to our business.

We also develop and obtain marketing and distribution rights to pharmaceutical agents in various stages of development. We have a variety of products under development, ranging from new products to existing product line extensions and reformulations of existing products. Our product development strategy involves the rapid evaluation and formulation of new therapeutics by obtaining preclinical safety and efficacy data, when possible, followed by rapid safety and efficacy testing in humans. In 2003, we expanded into the dermal aesthetic market through our acquisition of the exclusive United States and Canadian rights to market, distribute and commercialize the dermal restorative product lines known as RESTYLANE®, PERLANE™ and RESTYLANE FINE LINES™. As a result of our increasing financial strength, we have begun adding long-term projects to our development pipeline. Historically, we have supplemented our research and development efforts by entering into research and development agreements with other pharmaceutical and biotechnology companies.

Table of Contents

OMNICEF® is a trademark of Fujisawa Pharmaceutical Co. Ltd. and is used under a license from Abbott Laboratories, Inc. (Abbott). On April 1, 2005, Fujisawa Pharmaceutical Co. Ltd. merged with Yamanouchi Pharmaceutical Co. Ltd., creating Astelles Pharma, Inc.

Our Products

We currently market 15 branded products. Our sales and marketing efforts are currently focused on our core brands, which, during the Transition Period and fiscal 2005, accounted for approximately 84% and 76%, respectively, of our total net revenues. The following chart details certain important features of our core brands:

Brand	Treatment	U.S. Market Impact
DYNACIN®	Oral adjunctive treatment for severe acne	The number one branded minocycline product in the U.S., DYNACIN® tablets and capsules are available in a range of strengths
LOPROX®	Topical treatment for certain fungal and yeast infections in adults	A leading antifungal agent, including the number one branded shampoo for seborrheic dermatitis
OMNICEF®	A patented oral cephalosporin for skin and skin-structure infections	Superior kill rate compared to most frequently prescribed antibiotic for this indication
PLEXION®	Topical treatments for acne vulgaris, acne rosacea and seborrheic dermatitis	Includes the leading branded prescription cleanser indicated for the treatment of rosacea, and the first prescription cleansing cloth for the treatment of acne and rosacea
RESTYLANE®	Injectable gel for treatment of severe facial wrinkles and folds, such as nasolabial folds	Launched on January 6, 2004, following approval by the Food and Drug Administration (FDA) on December 12, 2003, is the leading worldwide injectible dermal filler
TRIAZ®	Topical patented gel and cleanser and patent-pending pad treatments for acne	The leading branded prescription benzoyl peroxide product
VANOS tm	Super-high potency topical corticosteroid for the treatment of plaque-type psoriasis in adult patients affecting up to 10% body surface area	Launched on April 19, 2005 following FDA approval on February 11, 2005

Prescription Pharmaceuticals

Our principal branded pharmaceutical products are described below:

DYNACIN® is an oral antibiotic, available in 50-mg., 75-mg. and 100-mg. tablet and capsule dosage forms, and is prescribed as an adjunctive therapy in severe acne. The most commonly prescribed systemic acne treatments are tetracycline and its derivatives, minocycline and doxycycline. Minocycline, the active ingredient in DYNACIN®, is widely prescribed for the treatment of acne for several reasons. It has a more convenient dosing schedule, two doses per day, as compared to other forms of tetracycline, which can require up to four doses per day. Other forms of tetracycline, including doxycycline, require ingestion on an empty stomach and have been reported to often cause gastric irritation and photosensitivity. In addition, resistance to several commonly used antibiotics, including erythromycin, clindamycin, doxycycline and tetracycline, by the primary bacterial organism responsible for acne has been documented. Our DYNACIN® products compete with branded products such as Doryx®, Adoxa®, Monodox®, and myrac™, as well as various generic products. DYNACIN® capsules were launched in fiscal 1993 with 50-mg. and 100-mg. dosage forms available. We launched DYNACIN® capsules in a 75-mg. dosage form in fiscal 1999. During fiscal 2003, we launched

Table of Contents

DYNACIN® in tablet form in 75-mg. and 100-mg. dosages, and we launched the 50-mg. dosage in fiscal 2004.

LOPROX® gel is a broad-spectrum prescription antifungal agent indicated for the topical treatment of interdigital tinea pedis, tinea corporis, and the topical treatment of seborrheic dermatitis of the scalp. Currently, LOPROX® Gel is the only gel approved in the United States for seborrheic dermatitis. In addition to the gel formulation of LOPROX®, we market LOPROX® cream and topical suspension for the topical treatment of tinea pedis, tinea corporis, tinea cruris, tinea versicolor and cutaneous candidiasis. LOPROX® works with a unique mode of action and has been shown to have fungistatic and fungicidal properties. The most frequently prescribed topical antifungal products in addition to LOPROX® include competitor products Spectazole®, Nizoral®, Oxistat® and Lotrisone® (steroid/antifungal combination). There are also generic versions of many of our LOPROX® products available in the market. During fiscal 2003, we launched LOPROX® Shampoo, which was the first prescription antifungal shampoo approved in the United States for the treatment of seborrheic dermatitis of the scalp, a common fungal infection.

OMNICEF® is indicated for the treatment of uncomplicated skin and skin-structure infections. Studies show that OMNICEF® has superior pathogen eradication rates versus Cephalexin, the most frequently prescribed antibiotic for uncomplicated skin and skin-structure infections. OMNICEF® has been promoted to dermatologists and podiatrists since May 2001 pursuant to our exclusive co-promotion agreement with Abbott. In return, we receive commission revenue from Abbott based on prescriptions generated in these categories. Our agreement with Abbott expires in 2013.

PLEXION® treats acne vulgaris, acne rosacea and seborrheic dermatitis with internally developed cleanser and topical therapies. Acne rosacea is a chronic skin condition causing inflammation and redness of the face. The active ingredients in our PLEXION® products are sodium sulfacetamide and sulfur. PLEXION®, the patented leading branded prescription cleanser indicated for the treatment of acne rosacea, was launched in fiscal 2000. The topical acne rosacea market is comprised of competitor products such as MetroGel®, MetroCream® and MetroLotion®. PLEXION TS®, a gentle topical suspension, was launched in fiscal 2001. In addition, during fiscal 2002 we launched PLEXION SCT®, a short contact therapy with a silica base that helps remove impurities from the skin pores. During fiscal 2005, we launched the first prescription cleansing cloth, PLEXION® Cleansing Cloths. Within its first three months on the market, PLEXION® Cleansing Cloths became the leading branded sodium sulfacetamide and sulfur cleansing formulation in new prescriptions.

TRIAZ®, an internally developed topical therapy prescribed for the treatment of numerous forms and varying degrees of acne, is available as a patented gel or cleanser or in a patent-pending pad in three concentrations. TRIAZ® products are manufactured using the active ingredient benzoyl peroxide in a patented vehicle containing glycolic acid and zinc lactate. Studies conducted by third parties have shown that benzoyl peroxide is the most efficacious agent available for eradicating the bacteria that cause acne with no reported resistance. We introduced the TRIAZ® brand in fiscal 1996. In July 2003, we launched TRIAZ® Pads, the first and only benzoyl peroxide pad available in the U.S. indicated for the topical treatment of acne vulgaris.

VANOS™ cream, launched to dermatologists in April 2005 after approval by the FDA on February 11, 2005, is a super-high potency (Class I) topical corticosteroid indicated for the treatment of plaque-type psoriasis in adult patients. Plaque-type psoriasis is the most common form of psoriasis, a chronic, recurrent skin disorder affecting up to 2% of the United States population and characterized by scaling, often itching plaques in certain areas of the body that typically follow a course of exacerbation and remission. The active ingredient in VANOS™ is fluocinonide 0.1%, and is the only fluocinonide available in the Class I category of topical corticosteroids. Physicians may already be familiar with the fluocinonide 0.05%, the active ingredient in another of our products, the Class II corticosteroid LIDEX®. Two double blind clinical studies have demonstrated the efficacy, safety and tolerability of VANOS™. Its base was formulated to have the cosmetic elegance of a cream, yet behave like an ointment on the skin. In addition, physicians have the flexibility of prescribing VANOS™ either once or twice daily. Considering that plaque-type psoriasis is recognized as a major challenge for physicians, and that VANOS™ is a new entry in its category, we believe VANOS™ will

Table of Contents

be an important treatment option for patients that suffer from plaque-type psoriasis. On March 2, 2006, the FDA broadened the indication of VANOS, and it is now indicated as a primary therapy for all inflammatory and pruritic skin conditions in patients 12 years of age of older which are responsive to cortocosteroids. Such conditions include eczema and poison ivy, which occur commonly.

Dermal Restorative Products

Our principal branded dermal restorative products are described below:

RESTYLANE®, PERLANE™, RESTYLANE FINE LINES™ and **SubQ™** are injectable, transparent, Non-Animal-Stabilized-Hyaluronic Acid (NASHA™) gels, which require no patient sensitivity tests in advance of product administration. These tissue tailored, transparent, injectable products, which come in pre-packaged, glass syringes, have varying gel particle sizes which provide physicians with flexibility in treating fine lines and wrinkles and correcting deep facial folds. In the United States, the FDA regulates these products as medical devices. Medicis offers all four of these products in Canada, and began offering RESTYLANE® in the United States on January 6, 2004. PERLANE™, RESTYLANE FINE LINES™ and SubQ™ have not yet been approved by the FDA for use in the United States. SubQ™ was approved for use in Canada on June 23, 2005. We acquired the exclusive U.S. and Canadian rights to these dermal restorative products from Q-Med AB, a Swedish biotechnology/medical device company and its affiliates (collectively Q-Med) through license agreements.

Research and Development

We develop and obtain rights to pharmaceutical agents in various stages of development. Currently, we have a variety of products under development, ranging from new products to existing product line extensions and reformulations of existing products. Our product development strategy involves the rapid evaluation and formulation of new therapeutics by obtaining preclinical safety and efficacy data, when possible, followed by rapid safety and efficacy testing in humans. As a result of our increasing financial strength, we have begun adding long-term projects to our development pipeline. Historically, we have supplemented our research and development efforts by entering into research and development agreements with other pharmaceutical and biotechnology companies.

On September 26, 2002, we entered into an exclusive license and development agreement with Dow Pharmaceutical Sciences, Inc. (Dow) for the development and commercialization of a patented dermatologic product. Under terms of the agreement, as amended, we made an initial payment of $5.4 million and a development milestone payment of $8.8 million to Dow during fiscal 2003, a development milestone payment of $2.4 million to Dow during fiscal 2004 and development milestone payments totaling $11.9 million to Dow during the Transition Period. In accordance with the agreement between the parties, Medicis is required to make a potential additional payment of $1.0 million upon the certification that a certain development milestone has occurred. All payments were recorded as charges to research and development expense in the periods in which the milestones were achieved.

On July 15, 2004, we entered into an exclusive license agreement and other ancillary documents with Q-Med to market, distribute, sell and commercialize in the United States and Canada Q-Med s product currently known as SubQ™. Q-Med has the exclusive right to manufacture SubQ™ for Medicis. SubQ™ is currently not approved for use in the United States. Under the terms of the license agreement, Medicis Aesthetics Holdings Inc., a wholly owned subsidiary of Medicis, licenses SubQ™ for approximately $80.0 million, due as follows: approximately $30.0 million paid on July 15, 2004, which was recorded as research and development expense during the first quarter of fiscal 2005; approximately $10.0 million upon successful completion of certain clinical milestones; approximately $20.0 million upon the satisfaction of certain defined regulatory milestones; and approximately $20.0 million upon U.S. launch of SubQ™. We also will make additional milestone payments to Q-Med upon the achievement of certain commercial milestones. SubQ™ is comprised of the same NASHA™ substance as RESTYLANE®, PERLANE™ and RESTYLANE FINE LINES™ with a larger gel particle size and has patent protection until at least 2015 in the United States.

Table of Contents

On December 13, 2004, we entered into an exclusive development and license agreement and other ancillary agreements with Ansata Therapeutics, Inc. (Ansata). The development and license agreement grants us the exclusive, worldwide rights to Ansata s early stage, proprietary antimicrobial peptide technology. In accordance with the development and license agreement, we paid $5.0 million upon signing of the contract and will pay approximately $9.0 million upon the successful completion of certain developmental milestones. Should we continue with the development of this technology, we will incur additional milestone payments beyond the development and license agreement. The initial $5.0 million payment was recorded as a charge to research and development expense during the second quarter of fiscal 2005.

On January 28, 2005, we amended our strategic alliance with aaiPharma, Inc. (aaiPharma) previously initiated in June 2002 for the development, commercialization and license of a dermatologic product. The consummation of the amendment has not affected the timing of the development project. The amendment allowed for the immediate transfer of the work product as defined under the agreement, as well as the product s management and development, to us, and provides that aaiPharma will continue to assist us with the development of the product on a fee for services basis. We will have no future financial obligations to pay aaiPharma on the attainment of clinical milestones, but we incurred approximately $8.3 million as a charge to research and development expense during the third quarter of fiscal 2005, as part of the amendment and the assumption of all liabilities associated with the project.

We incurred total research and development costs for all of our sponsored and unreimbursed co-sponsored pharmaceutical projects for the Transition Period, the corresponding six-month period of 2004, fiscal 2005, fiscal 2004 and fiscal 2003 of $22.4 million, $45.1 million, $65.7 million, $16.5 million and $29.6 million, respectively. Research and development costs for the Transition Period include $11.9 million paid to Dow pursuant to the development agreement. Research and development costs for the corresponding six-month period of 2004 include $30.0 million related to our license agreement with Q-Med related to the SubQ^{tm} product, and $5.0 million related to our development and license agreement with Ansata. Research and development costs for fiscal 2005 include $30.0 million related to our license agreement with Q-Med related to the SubQ^{tm} product, $5.0 million related to our development and license agreement with Ansata and $8.3 million related to our research and development collaboration with aaiPharma. Research and development costs for fiscal 2004 include $2.4 million paid to Dow pursuant to the development agreement. Research and development costs for fiscal 2003 include $14.2 million paid to Dow pursuant to the development agreement, and $6.0 million related to our research and development collaboration with aaiPharma.

Sales and Marketing

Our combined dedicated sales force, consisting of 163 employees as of December 31, 2005, focuses on high prescribing dermatologists, plastic surgeons and podiatrists. Since a relatively small number of physicians are responsible for writing a majority of dermatological and podiatric prescriptions and performing dermal aesthetic procedures, we believe that the size of our sales force is appropriate to reach our target physicians. Our therapeutic dermatology and podiatric sales forces consist of 110 employees who regularly call on approximately 9,300 dermatologists and 3,200 podiatrists. Our dermal aesthetic sales force consists of 53 employees who regularly call on leading plastic surgeons, facial plastic surgeons, dermatologists and dermatologic surgeons. We also have seven national account managers who regularly call on managed care organizations, large retail chains, formularies and related organizations.

We cultivate relationships of trust and confidence with the high prescribing dermatologists and podiatrists and the leading plastic surgeons in the United States. We use a variety of marketing techniques to promote our products including sampling, journal advertising, promotional materials, specialty publications, coupons, money-back or product replacement guarantees, educational conferences and informational websites.

We believe we have created an attractive incentive program for our sales force that is based upon goals in prescription growth and market share achievement.

Table of Contents

Warehousing and Distribution

We utilize an independent national warehousing corporation to store and distribute our products from primarily two regional warehouses in Nevada and Georgia, as well as additional warehouses in Maryland and North Carolina. Upon the receipt of a purchase order through electronic data input (EDI), phone, mail or facsimile, the order is processed through our inventory management systems and is transmitted electronically to the appropriate warehouse for picking and packing. Upon shipment, the warehouse sends back to us via EDI the necessary information to automatically process the invoice in a timely manner.

Customers

Our customers include certain of the nation s leading wholesale pharmaceutical distributors, such as AmerisourceBergen Corporation (AmerisourceBergen), Cardinal Health, Inc. (Cardinal), McKesson Corporation (McKesson) and other major drug chains. During the Transition Period, the comparable six-month period in 2004, and the last three full fiscal years, these customers accounted for the following portions of our net revenues:

	Transition Period	Comparable Six-Month Period in 2004	Fiscal 2005	Fiscal 2004	Fiscal 2003
McKesson	54.9%	50.8%	51.2%	36.9%	20.2%
Cardinal	18.9%	19.7%	21.8%	23.8%	25.4%
Quality King	*	*	*	*	17.0%
AmerisourceBergen	*	*	*	*	15.5%

* less than 10%

McKesson is our sole distributor of our RESTYLANE® products in the United States and Canada. RESTYLANE®, our highest-selling product during the Transition Period and fiscal 2005, was launched in the United States in January 2004.

Seasonality

Our business, taken as a whole, is not materially affected by seasonal factors, although a substantial portion of our prescription product revenues has been recognized in the last month of each quarter and we schedule our inventory purchases to meet anticipated customer demand. As a result, relatively small delays in the receipt of manufactured products by us could result in revenues being deferred or lost.

Manufacturing

We currently outsource all of our manufacturing needs, and we are required by the FDA to contract only with manufacturers who comply with current Good Manufacturing Practices (cGMP) regulations and other applicable laws and regulations. Typically our manufacturing contracts are short-term. We review our manufacturing arrangements on a regular basis and assess the viability of alternative manufacturers if our current manufacturers are unable to fulfill our needs.

Patheon, Inc. (Patheon) manufactures the capsule form of our DYNACIN® branded products under a supply agreement that automatically renews on an annual basis, unless terminated by either party. Par Pharmaceutical, Inc. (Par) manufactures the tablet form of our DYNACIN® branded products in accordance with a supply agreement that expires in June 2012.

Our PLEXION® and TRIAZ® branded products are manufactured by Contract Pharmaceuticals Limited pursuant to a manufacturing agreement that automatically renews on an annual basis, unless terminated by either party.

Our LOPROX® gel branded products are manufactured by Aventis S.A. (Aventis) in accordance with a supply agreement that renews automatically on an annual basis, unless terminated by either party. Our

Table of Contents

LOPROX® TS and LOPROX® shampoo branded products are manufactured by Patheon under a supply agreement that automatically renews on an annual basis, unless terminated by either party. Our LOPROX® cream branded product is manufactured by both Aventis and Patheon.

Our OMNICEF® branded product, which we promote through a license agreement with Abbott, is manufactured, warehoused and distributed by Abbott. The license agreement expires in 2013.

Our RESTYLANE® branded product is manufactured by Q-Med pursuant to a long-term supply agreement that expires no earlier than 2013.

Our VANOS™ branded product is manufactured by Patheon under a supply agreement that automatically renews on an annual basis, unless terminated by either party.

Raw Materials

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. 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.

License and Royalty Agreements

Pursuant to license agreements with third parties, we have acquired rights to manufacture, use or market certain of our existing products, as well as many of our development products and technologies. Such agreements typically contain provisions requiring us to use our best efforts or otherwise exercise diligence in pursuing market development for such products in order to maintain the rights granted under the agreements and may be canceled upon our failure to perform our payment or other obligations. In addition, we have licensed certain rights to manufacture, use and sell certain of our technologies outside the United States and Canada to various licensees.

Trademarks, Patents and Proprietary Rights

We believe that trademark protection is an important part of establishing product and brand recognition. We own a number of registered trademarks and trademark applications. U.S. federal registrations for trademarks remain in force for 10 years and may be renewed every 10 years after issuance, provided the mark is still being used in commerce.

We have obtained and licensed a number of patents covering key aspects of certain of our products, including a U.S. patent expiring in October 2015 covering various formulations of TRIAZ®, a U.S. patent expiring in 2015 covering RESTYLANE®, a U.S. patent expiring in 2020 covering PLEXION® cleanser formulation, a U.S. patent expiring in 2020 covering PLEXION® topical suspension and SCT formulations and a U.S. patent expiring in December 2021 covering VANOS™. We have patent applications pending relating to our PLEXION® cleansing cloths formulation and our LOPROX® gel and shampoo formulations. We are also pursuing several other U.S. and foreign patent applications.

We rely and expect to continue to rely upon unpatented proprietary know-how and technological innovation in the development and manufacture of many of our principal products. Our policy is to require all our employees, consultants and advisors to enter into confidentiality agreements with us.

Our success with our products will depend, in part, on our ability to obtain, and successfully defend if challenged, patent or other proprietary protection. However, the issuance of a patent is not conclusive as to its validity or as to the enforceable scope of the claims of the patent. Accordingly, our patents may not prevent other companies from developing similar or functionally equivalent products or from successfully challenging the validity of our patents. As a result, if our patent applications are not approved or, even if approved, such patents are circumvented or not upheld in a legal proceeding, our ability to competitively exploit our patented products and technologies may be significantly reduced. Also, such patents may or may not provide

Table of Contents

competitive advantages for their respective products or they may be challenged or circumvented by competitors, in which case our ability to commercially exploit these products may be diminished.

From time to time, we may need to obtain licenses to patents and other proprietary rights held by third parties to develop, manufacture and market our products. If we are unable to timely obtain these licenses on commercially reasonable terms, our ability to commercially exploit such products may be inhibited or prevented.

Competition

The pharmaceutical and dermal aesthetics industries are characterized by intense competition, rapid product development and technological change. As a result, competition is intense among manufacturers of prescription pharmaceuticals and dermal injection products, such as for our core brands.

Many of our competitors are large, well-established pharmaceutical, chemical, cosmetic or health care companies with considerably greater financial, marketing, sales and technical resources than those available to us. Additionally, many of our present and potential competitors have research and development capabilities that may allow them to develop new or improved products that may compete with our product lines. Our products could be rendered obsolete or made uneconomical by the development of new products to treat the conditions addressed by our products, technological advances affecting the cost of production, or marketing or pricing actions by one or more of our competitors. Each of our products competes for a share of the existing market with numerous products that have become standard treatments recommended or prescribed by dermatologists and podiatrists and administered by plastic surgeons and aesthetic dermatologists.

The largest competitors for our prescription dermatological products include Bristol-Myers Squibb, Galderma, GlaxoSmithKline, Johnson & Johnson, Pfizer, sanofi-aventis, Schering-Plough, Valeant Pharmaceuticals, Wyeth and others. Several of our core prescription brands compete or may compete in the near future with generic (non-branded) pharmaceuticals, which claim to offer equivalent therapeutic benefits at a lower cost. In some cases, insurers and other third-party payors seek to encourage the use of generic products, making branded products less attractive, from a cost perspective, to buyers. On July 18, 2004, Glades Pharmaceuticals, LLC (Glades), a wholly owned subsidiary of Stiefel Laboratories, Inc., announced the launch of myrac™ (minocycline hydrochloride tablets, USP), as a branded pharmaceutical product. Myrac™ tablets is a prescription product that competes directly with our DYNACIN® tablet products. During the third quarter of our fiscal 2005, myrac™ began being marketed as a generic product. On August 6, 2004, the FDA approved an Abbreviated New Drug Application (ANDA) submitted by Altana, Inc. (Altana) for its ciclopirox topical suspension, a generic version of our LOPROX® TS product. On December 29, 2004, the FDA approved an ANDA submitted by Altana for its ciclopirox cream, a generic version of our LOPROX® Cream product. On August 10, 2005, the FDA approved an ANDA submitted by Taro Pharmaceuticals U.S.A. Inc. (Taro) for its ciclopirox topical suspension, a generic version of our LOPROX® topical suspension. On March 7, 2006, the Perrigo Company announced that it received approval from the FDA to manufacture and market its ciclopirox olamine cream USP, 0.77%, a generic version of our LOPROX® Cream product.

Our facial aesthetics products compete against Inamed Corporation (Inamed) and Allergan Inc. On December 6, 2005, Inamed announced that it had submitted the fourth and final module of its Premarket Approval Application for three formulations of Juvederm™, a dermal filler product. Allergan Inc., the marketer of Botox®, is a larger company than Medicis, and has greater financial, marketing, sales and technical resources than those available to us. Allergan Inc. and Inamed are parties to a definitive merger agreement pursuant to which Allergan will acquire Inamed. 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, if approved, the companies producing such products could charge less to doctors for their products.

Table of Contents

Government Regulation

The manufacture and sale of biological products, drugs and medical devices are subject to regulation principally by the FDA, but also by other federal agencies and state and local authorities in the United States, and by comparable agencies in certain foreign countries. The Federal Trade Commission (FTC), the FDA and state and local authorities regulate the advertising of over-the-counter drugs and cosmetics. The Federal Food, Drugs and Cosmetics Act and the regulations promulgated thereunder, and other federal and state statutes and regulations, govern, among other things, the testing, manufacture, safety, effectiveness, labeling, storage, record keeping, approval, sale, distribution, advertising and promotion of our products.

Our RESTYLANE® dermal filler product is a medical device intended for human use and is subject to regulation by the FDA in the United States. Unless an exemption applies, each medical device we market in the U.S. must have a Premarket Approval Application (PMA) in accordance with the Federal Food, Drug, and Cosmetic Act, as amended, or a 510(k) clearance (a demonstration that the new device is substantially equivalent to a device already on the market). FDA device regulations generally require reasonable assurance of safety and effectiveness prior to marketing, including safety and efficacy data obtained under clinical protocols approved under an Investigational Device Exemption (IDE) and require compliance with quality systems regulations (QSRs), as verified by detailed FDA investigations of manufacturing facilities. These regulations also require post-approval reporting of alleged product defects, recalls and certain adverse experiences to the FDA. FDA regulations divide medical devices into three classes. Class I devices are subject to general controls that require compliance with device establishment registration, product listing, labeling, QSRs and other general requirements that are also applicable to all classes of medical devices. Class II devices are subject to special controls in addition to general controls and generally require the submission of a premarket notification before marketing is permitted. Class III devices are subject to the most comprehensive regulation and in most cases require submission to the FDA of a PMA application that includes biocompatibility, manufacturing and clinical data supporting the safety and effectiveness of the device as well as compliance with the same provisions applicable to all medical devices such as QSRs. Annual reports must be submitted to the FDA, as well as descriptions of certain adverse events that are reported to the sponsor within specified timeframes of receipt of such reports. RESTYLANE® is regulated as a Class III medical device. RESTYLANE® has been approved by the FDA under a PMA.

In general, products falling within the FDA s definition of new drugs require premarket approval by the FDA. Products falling within the FDA s definition of cosmetics or of drugs (if they are not also new drugs) and that are generally recognized as safe and effective do not require premarketing clearance although all drugs must comply with a host of post-market regulations, including manufacture under cGMP. The steps required before a new drug may be marketed in the United States include (i) preclinical laboratory and animal testing; (ii) manufacture under cGMP; (iii) submission to the FDA of an Investigational New Drug (or IND) application, which must become effective before clinical trials may commence; (iv) usually at least two adequate and well-controlled clinical trials to establish the safety and efficacy of the drug; (for some applications, the FDA may accept one large clinical trial) (v) submission to the FDA of a New Drug Application (or NDA); and (vi) FDA approval of the NDA before any commercial sale or shipment of the drug. In addition to obtaining FDA approval for each product, each drug-manufacturing establishment must be registered with, and approved by, the FDA.

New drugs may also be approved by the agency pursuant to an ANDA for generic drugs if the same active ingredient has previously been approved by the agency and the original sponsor of the NDA no longer has patent protection or statutory marketing exclusivity. Approval of an ANDA does not require the submission of clinical data on the safety and effectiveness of the drug product. However, the applicant must provide dissolution and/or metabolic studies to show that the active ingredient in the generic drug sponsor s application is comparably available to the patent as the original product in the NDA upon which the ANDA is based.

Preclinical or biocompatibility testing is generally conducted on laboratory animals to evaluate the potential safety and toxicity of a drug. The results of these studies are submitted to the FDA as a part of an IND or IDE application, which must be approved before clinical trials in humans can begin. Typically, clinical

Table of Contents

evaluation of new drugs involves a time consuming and costly three-phase process. In Phase I, clinical trials are conducted with a small number of subjects to determine the early safety profile, the relationship of safety to dose, and the pattern of drug distribution and metabolism. In Phase II, one or more clinical trials are conducted with groups of patients afflicted with a specific disease to determine preliminary efficacy and expanded evidence of safety. In Phase III, at least two large-scale, multi-center, comparative trials are conducted with patients afflicted with a target disease to provide sufficient confirmatory data to support the efficacy and safety required by the FDA. The FDA closely monitors the progress of each of the three phases of clinical trials and may, at its discretion, re-evaluate, alter, suspend or terminate the testing based upon the data that have been accumulated to that point and its assessment of the risk/benefit ratio to the patient.

FDA approval is required before a new drug product may be marketed in the United States. However, many historically over-the-counter (OTC) drugs are exempt from the FDA s premarket approval requirements. In 1972, the FDA instituted the ongoing OTC Drug Review to evaluate the safety and effectiveness of OTC drugs then in the market before enactment of the Drug Amendments of 1962. Through this process, the FDA issues monographs that set forth the specific active ingredients, dosages, indications and labeling statements for OTC drugs that the FDA will consider generally recognized as safe and effective and therefore not subject to premarket approval. Before issuance of a final OTC drug monograph as a federal regulation, OTC drugs are classified by the FDA in one of three categories: Category I ingredients which are deemed safe and effective for over-the-counter use; Category II ingredients which are deemed not generally recognized as safe and effective for over-the-counter use; and Category III ingredients which are deemed possibly safe and effective with studies ongoing. Based upon the results of these ongoing studies, the FDA must reclassify all Category III ingredients as either Category I or Category II before issuance of a final monograph. For certain categories of OTC drugs not yet subject to a final monograph, the FDA usually permits such drugs to continue to be marketed until a final monograph becomes effective, unless the drug will pose a potential health hazard to consumers. Stated differently, the FDA generally permits continued marketing only of Category I and III products during the pendency of a final monograph. Drugs subject to final monographs, as well as drugs that are subject only to proposed monographs, are subject to various FDA regulations concerning, for example, cGMP, general and specific OTC labeling requirements and prohibitions against promotion for conditions other than those stated in the labeling. OTC drug manufacturing facilities are subject to FDA inspection, and failure to comply with applicable regulatory requirements may lead to administrative or judicially imposed penalties.

Each of the active ingredients in LOPROX® products and OMNICEF® products have been approved by the FDA under an NDA. The active ingredient in DYNACIN® branded products has been approved by the FDA under an ANDA. The active ingredient in the TRIAZ® products has been classified as a Category III ingredient under a tentative final FDA monograph for OTC use in treatment of labeled conditions. The FDA has requested, and a task force of the Non-Prescription Drug Manufacturers Association (or NDMA), a trade association of OTC drug manufacturers, has undertaken further studies to confirm that benzoyl peroxide, an active ingredient in the TRIAZ® products, is not a tumor promoter when tested in conjunction with UV light exposure. The TRIAZ® products, which we sell on a prescription basis, have the same ingredients at the same dosage levels as the OTC products. When the FDA issues the final monograph, one of several possible outcomes that may occur is that we may be required by the FDA to discontinue sales of TRIAZ® products until and unless we file an NDA covering such product. There can be no assurance as to the results of these studies or any FDA action to reclassify benzoyl peroxide. In addition, there can be no assurance that adverse test results would not result in withdrawal of TRIAZ® products from marketing. An adverse decision by the FDA with respect to the safety of benzoyl peroxide could result in the assertion of product liability claims against us and could have a material adverse effect on our business, financial condition and results of operations.

Our TRIAZ® branded products must meet the composition and labeling requirements established by the FDA for products containing their respective basic ingredients. We believe that compliance with those established standards avoids the requirement for premarket clearance of these products. There can be no assurance that the FDA will not take a contrary position in the future. Our PLEXION® branded products,

Table of Contents

which contain the active ingredients sodium sulfacetamide and sulfur, are marketed under the FDA compliance policy entitled Marketed New Drugs without Approved NDAs or ANDAs.

We believe that certain of our products, as they are promoted and intended by us for use, are exempt from being considered new drugs based upon the introduction date of their active ingredients and therefore do not require premarket clearance. There can be no assurance that the FDA will not take a contrary position in the future. If the FDA were to do so, we may be required to seek FDA approval for these products, market these products as over-the-counter products or withdraw such products from the market. We believe that these products are compliant with applicable regulations governing product safety, use of ingredients, labeling, promotion and manufacturing methods.

We also will be subject to foreign regulatory authorities governing clinical trials and pharmaceutical sales for products we seek to market outside the United States. Whether or not FDA approval has been obtained, approval of a product by the comparable regulatory authorities of foreign countries must be obtained before marketing the product in those countries. The approval process varies from country to country, the approval process time required may be longer or shorter than that required for FDA approval, and any foreign regulatory agency may refuse to approve any product we submit for review.

Our History

We filed our certificate of incorporation with the Secretary of State of Delaware on July 28, 1988. We completed our initial public offering during our fiscal year ended June 30, 1990, and launched our initial pharmaceutical products during our fiscal year ended June 30, 1991. During our fiscal year ended June 30, 2003, we acquired the exclusive U.S. and Canada license to the RESTYLANE® family of products.

Financial Information About Segments

We operate in one significant business segment: Pharmaceuticals. Our current pharmaceutical franchises are divided between the dermatological and non-dermatological fields. Information on revenues, operating income, identifiable assets and supplemental revenue of our business franchises appears in the consolidated financial statements included in Item 8 hereof.

Employees

At December 31, 2005, we had 356 full-time employees. No employees are subject to a collective bargaining agreement. We believe our relationship with our employees is good.

Available Information

We make available free of charge on or through our Internet website, www.medicis.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports, if any, filed or furnished pursuant to Section 13(a) of 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission. We also make available free of charge on or through our website our Business Code of Conduct and Ethics, Corporate Governance Guidelines, Nominating and Corporate Governance Committee Charter, Compensation Committee Charter and Audit Committee Charter. The information contained on our website is not intended to be incorporated into this annual report on Form 10-K/T.

Item 1A. ***Risk Factors***

Our statements in this report, other reports that we file with the Securities and Exchange Commission, our press releases and in public statements of our officers and corporate spokespersons contain forward-looking statements Within the meaning of Section 27A of the Securities Act of 1933, Section 21 of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. You can identify these statements by the fact that they do not relate strictly to historical or current events, and contain words such as anticipate, estimate, expect, project , in will , plan, believe , should , outlook ,

Table of Contents

could , target and other words of similar meaning in connection with discussion of future operating or financial performance. These include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, the outcome of contingencies such as legal proceedings and financial results. 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. Such statements are subject to a number of assumptions, risks and uncertainties, many of which are beyond our control. These forward-looking statements reflect the current views of senior management with respect to future events and financial performance. No assurances can be given, however, that these activities, events or developments will occur or that such results will be achieved, and actual results may vary materially from those anticipated in any forward-looking statement. Any such forward-looking statements, whether made in this report or elsewhere, should be considered in context of the various disclosures made by us about our businesses including, without limitation, the risk factors discussed below. We do not plan to update any such forward-looking statements and expressly disclaim any duty to update the information contained in this filing except as required by law.

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

We derive a majority of our sales from our core 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 core prescription products and sales of our dermal aesthetic product, RESTYLANE®, which we began selling in the United States on January 6, 2004, 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 December 6, 2005, Inamed announced that it had submitted the fourth and final module of its Premarket Approval Application for three formulations of Juvederm™, a dermal filler product that would compete with RESTYLANE® if approved by the FDA. Many of our core prescription products, including DYNACIN® and LOPROX®, are subject to generic competition or may be in the near future. On July 18, 2004, Glades announced the launch of myrac™ (minocycline hydrochloride tablets, USP), as a branded pharmaceutical product. Myrac™ tablets is a prescription product that competes directly with our DYNACIN® tablet products. During the third quarter of our fiscal 2005, myrac™ began being marketed as a generic product. On August 6, 2004, the FDA approved an ANDA submitted by Altana for its ciclopirox topical suspension, a generic version of our LOPROX® TS product. On December 29, 2004, the FDA approved an ANDA submitted by Altana for its ciclopirox cream, a generic version of our LOPROX® cream product. On August 10, 2005, the FDA approved an ANDA submitted by Taro Pharmaceuticals U.S.A. Inc. (Taro) for its ciclopirox topical suspension, a generic version of our LOPROX® topical suspension. On March 7, 2006, the Perrigo Company announced that it received approval from the FDA to manufacture and market its ciclopirox olamine cream USP, 0.77%, a generic version of our LOPROX® Cream product. Each of our core products could be rendered obsolete or uneconomical by competitive changes, including generic competition.

Sales related to our core prescription products and RESTYLANE® 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 core products, including the introduction of new products into the marketplace;

marketing or pricing actions by one or more of our competitors;

Table of Contents

regulatory action by the FDA and other government regulatory agencies;

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.

If we do not comply with applicable regulatory requirements, such violations could result in warning letters, non-approval, suspensions of regulatory approvals, civil penalties and criminal fines, product seizures and recalls, operating restrictions, injunctions and criminal prosecution. The government has notified us that we have been named as a defendant in a qui tam (whistleblower) lawsuit filed under the False Claims Act. We are cooperating with the government in its investigation, which relates to our marketing and promotion of LOPROX® products to pediatricians prior to our May 2004 disposition of our pediatric sales division.

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 by others;

the timing and receipt of FDA approvals;

changes in the amount we spend to develop, acquire or license new products, technologies or businesses;

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;

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;

Table of Contents

lower than expected demand for our products;

our responses to price competition;

expenditures as a result of legal actions;

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 core 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.

We will be unable to meet our anticipated development and commercialization timelines if clinical trials for our products are unsuccessful or delayed

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;

government or regulatory delays; and

unanticipated requests from the FDA for new or additional information.

Table of Contents

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.

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. Challenges may result in potentially significant harm to our business. The cost of responding to these challenges and the inherent costs to defend the validity of our patents, including the prosecution of infringements and the related litigation, could be substantial. Such litigation also could require a substantial commitment of our management s time.

We are pursuing several United States patent applications; although we cannot be sure that any of these patents will ever be issued. 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 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 core 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

15

Table of Contents

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.

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

RESTYLANE®, PERLANE™ and RESTYLANE FINE LINES™ 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 7 to our consolidated financial statements, BioMarin will make license payments to us of $2.1 million per quarter for four quarters beginning in July 2005; $1.75 million per quarter for the subsequent eight quarters beginning in July 2006; 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 Transition Period and during the fiscal year ending June 30, 2005, we cannot give any assurances as to BioMarin s continuing ability to make payments to us. Currently, our revenue recognition of these payments is on a cash basis. In addition, we cannot give any assurances as to BioMarin s ability to make the $70.6 million payment to us in 2009 for the purchase of all of the outstanding shares of Ascent Pediatrics.

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. We have not entered into employment agreements with any of our key managers, with the exception of our Chairman and Chief Executive Officer. The loss of the services of any member of our senior management 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.

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 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.

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 commercial-

Table of Contents

ized. 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.

We may acquire companies in the future and these acquisitions could disrupt our business

As part of our business strategy, we regularly consider and, as appropriate, make acquisitions of technologies, products and businesses that we believe are complementary to our business. Acquisitions typically entail many risks and could result in difficulties in integrating the operations, personnel, technologies and products of the companies acquired, some of which may result in significant charges to earnings. If we are unable to successfully integrate our acquisitions with our existing business, we may not obtain the advantages that the acquisitions were intended to create, which may materially adversely affect our business, results of operations, financial condition and cash flows, 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 business or employee base, or key employees of companies that we acquire may seek employment elsewhere, including with our competitors.

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, have also tried 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 pursuant to the terms of such agreement. 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.

Table of Contents

Our success depends on our ability to manage our growth

We recently 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. Even if these steps are taken, we cannot be sure that our recent acquisitions will be integrated successfully into our business operations. If we are not able to successfully integrate our acquisitions, we may not obtain the advantages that the acquisitions were intended to create. In addition, 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.

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 core 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, and 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.

Our growth and acquisition strategy depends upon the successful integration of licensed products with our existing products. Therefore, any loss, limitation or flaw in a licensed product could impair our ability to market and sell our products, delay new product development and introduction, and harm our reputation. These problems, individually or together, could harm our business 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 AmerisourceBergen, Cardinal, McKesson, and major drug chains. 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 any of these customers accounts or a material reduction in their purchases could harm our business, financial condition or results of operations. In addition, we may face pricing pressure from our customers.

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 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 our company, cause a reduction in the inventory levels of distributors and retailers, result in reductions in purchases of our products,

Table of Contents

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 our entire 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. 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 core 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 covering the loss of income for up to 12 months, 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.

Our reliance on third-party manufacturers and suppliers can 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. 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.

We try to maintain inventory levels that are no greater than necessary to meet our current projections. 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.

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

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

Table of Contents

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.

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. These data are extrapolations from information provided only by certain pharmacies, and are estimates of historical demand levels. 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. There is no such timely data for the aesthetics market, in particular RESTYLANE®, our highest-selling product during the Transition Period and fiscal 2005. Our forecasts may fail to accurately anticipate ultimate customer demand for products. Overestimates of demand may result in excessive inventory production; underestimates may result in inadequate supply of our products in channels of distribution.

We sell our products primarily to major wholesalers and retail pharmacy chains. Consistent with pharmaceutical industry patterns, approximately 80% of our revenues are derived from three major drug wholesale concerns. While we attempt to estimate inventory levels of our products at our major wholesale customers, using historical prescription information and historical purchase patterns, this process is inherently imprecise. Rarely do wholesale customers provide us complete inventory levels at regional distribution centers, or within their national distribution systems. We rely wholly upon our wholesale and drug chain customers to effect the distribution allocation of our products.

We periodically offer promotions to wholesale and chain drugstore customers to encourage dispensing of our products, consistent with prescriptions written by licensed health care providers. Because many of our products compete in multi-source markets, it is important for us to ensure the licensed health care providers dispensing instructions are fulfilled with our branded products and are not substituted with a generic product or another therapeutic alternative product which may be contrary to the licensed health care providers recommended 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

20

Table of Contents

customers as may be necessary to ensure the fullest possible distribution of our branded products within the pharmaceutical chain of commerce.

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

Fluctuations in demand for our products create inventory maintenance uncertainties

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

We 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 in these areas, additional financial resources are expected to be utilized. 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 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

Table of Contents

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.

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.

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.

RESTYLANE® is a consumer product and as such, it is susceptible to changes in popular trends and applicable laws, which could adversely affect sales or product margins of RESTYLANE®

RESTYLANE® is a consumer product. 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®. 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 facial aesthetic products. Consumer perceptions of RESTYLANE® may be negatively impacted by these reports and other reasons.

Demand for RESTYLANE® may be materially adversely affected by changing economic conditions. Generally, the costs of cosmetic procedures are borne by individuals without reimbursement from their

Table of Contents

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® 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, 2007, 2012 and 2017 and 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 and 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. We may not have sufficient funds at the time of any such events to make the required repurchases.

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. 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 Securities and Exchange Commission (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.

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

Table of Contents

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.

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 recalls;

delays in product distribution, marketing and sale; and

civil or criminal sanctions.

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

Table of Contents

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.

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.

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 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. For example, we have been notified by the government that we have been named as a defendant in a qui tam (whistleblower) lawsuit filed under the federal False Claims Act, related to our marketing and promotion of LOPROX® products to pediatricians. See Item 3. Legal Proceedings of this Form 10-K/ T.

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.

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. 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;

Table of Contents

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.

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, Bristol-Myers Squibb, Galderma, GlaxoSmithKline, Inamed, Johnson & Johnson, Pfizer, sanofi-aventis, Schering-Plough, Valeant Pharmaceuticals, Wyeth 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

Table of Contents

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 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.

Item 1B. ***Unresolved Staff Comments***

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of the Transition Period and that remain unresolved.

Item 2. ***Properties***

Our office space in Scottsdale, Arizona has approximately 75,000 square feet under an amended lease agreement that expires in December 2010. The average annual expense under the amended lease agreement is approximately $2.1 million. The lease contains certain rent escalation clauses and, upon expiration, can be renewed for two additional periods of five years each.

Medicis Aesthetics Canada Ltd., a wholly owned subsidiary, presently leases approximately 3,600 square feet of office space in Toronto, Ontario, Canada, under a lease agreement that expires in February 2008.

Rent expense was approximately $1.2 million, $1.1 million, $2.3 million, $2.1 million and $1.5 million for the Transition Period, the comparable six-month period in 2004 and fiscal 2005, fiscal 2004 and fiscal 2003, respectively. We believe these properties are adequate for our current purposes, and we are currently pursuing additional headquarter office space to accommodate our expected long-term growth.

Item 3. ***Legal Proceedings***

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

Table of Contents

2005. On November 14, 2005, the Massachusetts Appeals Court issued a decision and order affirming the grant of summary judgment in favor of Ascent on all claims. Triumph did not file a timely request for further appellate review from the Massachusetts Supreme Judicial Court. Accordingly, the Appeals Court issued its rescript to the Massachusetts Superior Court and on December 28, 2005, the Superior Court entered judgment for defendant Ascent. This matter is closed. We are in the process of distributing the accumulated contingent purchase price payments of $27.4 million to the former shareholders of Ascent, as they were withheld pending final resolution of this matter.

On June 21, 2004, the United States International Trade Commission (ITC) instituted an investigation pursuant to Section 337 of the Tariff Act of 1930, as amended, at the request of Inamed. The investigation identified Medicis Aesthetics, Inc., a wholly owned subsidiary of our company, and Q-Med as respondents in the investigation regarding Inamed s allegation of infringement of its U.S. Patent No. 4,803,075, dated February 7, 1989, by the dermal filler, RESTYLANE®. On September 16, 2004, Inamed moved to add our distributor, McKesson Corporation (McKesson), as a respondent. The motion was granted by the Administrative Law Judge (ALJ) and affirmed by the ITC during November 2004. Inamed also filed a parallel infringement action against us and Q-Med in the U.S. District Court of the Southern District of California regarding the same patent. Inamed amended its complaint to add McKesson as a party to this action as well. This action was stayed pending the outcome of the ITC investigation. Pursuant to the Agreement and Plan of Merger (the Merger Agreement) and related transactions entered into by Medicis, Inamed and a wholly-owned subsidiary of Medicis on March 20, 2005, Inamed filed a motion to dismiss with prejudice Inamed s patent infringement action. In addition, Inamed consented to the dismissal of the ITC matter, which has been granted and has been made final. The matters are closed.

The government notified us on December 14, 2004, that it is investigating claims that we violated the federal False Claims Act. We are fully cooperating with the government in its investigation, which relates to our marketing and promotion of LOPROX® products to pediatricians prior to our May 2004, disposition of the Company s pediatric sales division.

On October 27, 2005, we filed suit against Upsher-Smith Laboratories, Inc. of Plymouth, Minnesota and against Prasco Laboratories of Cincinnati, Ohio for infringement of Patent No. 6,905,675 entitled Sulfur Containing Dermatological Compositions and Methods for Reducing Malodors in Dermatological Compositions covering our sodium sulfacetamide/sulfur technology. This intellectual property is 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. We are in the midst of accelerated discovery. A hearing on our preliminary injunction motion was heard on March 8th and 9th, 2006.

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.

Table of Contents

Item 4. ***Submission of Matters to a Vote of Security Holders***

On December 19, 2005, the Company held its 2005 Annual Meeting of Shareholders (the Annual Meeting). The holders of 50,551,674 shares of Class A Common Stock were present in person or represented by proxy at the meeting. The following is a summary of the results of the voting by the Company s shareholders at the Annual Meeting:

1) Election of Directors

The stockholders elected the following persons to serve as directors of the Company for a term of three years, or until their successors are duly elected and qualified or until their earlier resignation or removal. Votes were cast as follows:

	Number of Votes	
	For	**Withheld**
Spencer Davidson	30,806,330	19,745,344
Stuart Diamond	29,640,722	20,910,952
Peter S. Knight, Esq.	30,874,639	19,677,035

The directors of the Company whose terms of office continued were Mr. Jonah Shacknai, Mr. Arthur G. Altschul, Jr., Mr. Michael A. Pietrangelo, Mr. Philip S. Schein, M.D. and Ms. Lottie H. Shackelford.

2) The stockholders approved the appointment of Ernst & Young LLP as independent auditors for the Transition Period ending December 31, 2005. Votes were cast as follows:

For	**Against**	**Abstain**
50,405,690	134,354	11,630

3) Three proposals contained in our proxy statement were not acted upon at the Annual Meeting as a result of the termination of our Agreement and Plan of Merger with Inamed Corporation, dated March 20, 2005. These proposals were: (i) the issuance of shares of Medicis Class A common stock pursuant to the agreement and plan of merger, (ii) an amendment to our certificate of incorporation to increase the number of authorized shares of Medicis Class A common stock from 150,000,000 to 300,000,000 and change our name from Medicis Pharmaceutical Corporation to Medicis and (iii) authorization to postpone or adjourn the Annual Meeting to permit further solicitation of proxies if there were not sufficient votes at the time of the Annual Meeting in favor of the other matters being voted upon.

Table of Contents

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Description of Registrant s Securities, Price Range of Common Stock and Dividends Declared

Medicis Class A common stock trades on the New York Stock Exchange under the symbol MRX . The following table sets forth the high and low sale prices for our Class A common stock on the New York Stock Exchange for the fiscal periods indicated. Prices have been restated to reflect the 2 for 1 stock split effected in the form of a stock dividend that occurred on January 23, 2004:

	High	Low	Dividends Declared
TRANSITION PERIOD			
Three Months Ended September 30, 2005	$ 35.45	$ 31.08	$ 0.03
Three Months Ended December 31, 2005	35.16	26.30	0.03
FISCAL YEAR ENDED JUNE 30, 2005			
First Quarter	$ 40.65	$ 32.85	$ 0.03
Second Quarter	41.00	34.64	0.03
Third Quarter	37.67	28.69	0.03
Fourth Quarter	31.97	26.80	0.03
FISCAL YEAR ENDED JUNE 30, 2004			
First Quarter	$ 32.00	$ 27.27	$ 0.025
Second Quarter	36.01	27.81	0.025
Third Quarter	41.50	33.86	0.025
Fourth Quarter	45.26	38.45	0.025

On March 10, 2006, the last reported sale price on the New York Stock Exchange for Medicis Class A common stock was $28.93 per share. As of such date, there were approximately 223 holders of record of Class A common stock.

Dividend Policy

Since the beginning of fiscal 2004, we have paid quarterly cash dividends aggregating approximately $15.2 million on our common stock. In addition, on December 14, 2005, we declared a cash dividend of $0.03 per issued and outstanding share of common stock payable on January 31, 2006 to our stockholders of record at the close of business on January 3, 2006. Prior to these dividends, we had not paid a cash dividend on our common stock, and we have not adopted a dividend policy. Any future determinations to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon our financial condition, operating results, capital requirements and other factors that our Board of Directors deems relevant.

Our 1.5% Contingent Convertible Senior Notes due 2033 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.

Recent Sales of Unregistered Securities

None.

Equity Compensation Plan Information

Information required to be included about our equity compensation plan is incorporated by reference to the material under the caption Equity Compensation Plan Information in the proxy statement for our 2006 annual meeting of stockholders.

Table of Contents

Item 6. ***Selected Financial Data***

The following table sets forth selected consolidated financial data for the Transition Period, the corresponding six-month period in 2004 and the year ended December 31, 2005. The data for the Transition Period is derived from our audited consolidated financial statements and accompanying notes, while the data for the corresponding six-month period in 2004 and the year ended December 31, 2005 is derived from our unaudited consolidated financial statements. The comparability of the periods presented is impacted by certain product rights and business acquisitions and dispositions. Gross profit does not include amortization of the related intangibles.

	Transition Period	Six Months Ended December 31, 2004	Year Ended December 31, 2005
	(In thousands, except per share amounts)		
Statements of Operations Data:			
Net product revenues	$ 155,569	$ 146,999	$ 313,684
Net contract revenues	8,385	34,168	46,002
Net revenues	163,954	181,167	359,686
Gross profit(a)	139,843	153,897	307,398
Operating expenses:			
Selling, general and administrative	89,360(b)	65,736(e)	158,778(g)
Research and development	22,367(c)	45,140(f)	42,903(h)
Depreciation and amortization	12,420	10,222	24,548
Total operating expenses	124,147	121,098	226,229
Operating income	15,696	32,799	81,169
Other:			
Other income, net	59,801(d)		59,801(d)
Net interest income (expense)	4,726	(248)	5,804
Income tax expense	(30,502)	(11,328)	(53,288)
Net income	$ 49,721	$ 21,223	$ 93,486
Basic net income per share	$ 0.92	$ 0.38	$ 1.72
Diluted net income per share	$ 0.76	$ 0.34	$ 1.44(i)
Cash dividend declared per common share	$ 0.06	$ 0.06	$ 0.12
Basic common shares outstanding	54,323	55,972	54,290
Diluted common shares outstanding	69,772	72,160	69,558(i)

(a)

Amounts exclude $10.9 million, $8.9 million and $21.6 million of amortization expense related to acquired intangible assets for the Transition Period, the six months ended December 31, 2004, and the year ended December 31, 2005.

(b) Includes approximately $13.9 million of compensation expense related to stock options and restricted stock recognized during the Transition Period, a charge of approximately $9.2 million for the write-down of a long-lived asset and approximately $0.7 million of integration planning costs incurred related to the proposed Inamed transaction during the three months ended September 30, 2005.

(c) Includes approximately $11.9 million related to a research and development collaboration with Dow and approximately $1.0 million of compensation expense related to stock options and restricted stock.

Table of Contents

(d) Represents a termination fee of $90.5 million received from Inamed upon the termination of the proposed merger with Inamed, net of a termination fee paid to an investment banker and the expensing of accumulated transactions costs of $27.0 million, and integration costs incurred during the three months ended December 31, 2005 of $3.7 million.

(e) Includes approximately $1.3 million of professional fees related to research and development collaborations with Ansata and Q-Med.

(f) Includes $5.0 million paid to Ansata related to an exclusive development and license agreement and $30.0 million paid to Q-Med related to an exclusive license agreement for the development of SubQ[tm].

(g) Includes approximately $13.9 million of compensation expense related to stock options and restricted stock recognized during the Transition Period, a charge of approximately $9.2 million for the write-down of a long-lived asset and approximately $6.0 million of integration planning costs incurred related to the proposed Inamed transaction during the three months ended June 30, 2005 and three months ended September 30, 2005.

(h) Includes approximately $8.3 million paid to aaiPharma related to a research and development collaboration, $11.9 million related to a research and development collaboration with Dow and approximately $1.0 million of compensation expense related to stock options and restricted stock.

(i) Diluted net income per common share for the unaudited year ended December 31, 2005 was calculated by using the average of the periodic diluted common shares outstanding during the year. For the period from January 1, 2005 to June 30, 2005, diluted common shares outstanding was calculated using APB Opinion No. 25, while for the period from July 1, 2005 to December 31, 2005, diluted common shares outstanding was calculated using SFAS 123R. The Company adopted SFAS No. 123R effective July 1, 2005.

The balance sheet data as of December 31, 2004, and the cash flow data for the six months ended December 31, 2004, is unaudited.

	December 31,	
	2005	**2004**
	(In thousands)	
Balance Sheet Data:		
Cash, cash equivalents and short-term investments	$ 742,532(a)	$ 532,518
Working capital	692,453	552,391
Total assets	1,145,954	979,871
Long-term debt	453,065	453,065
Stockholders equity	543,487	444,826

	Transition Period	Six Months Ended Dec. 31, 2004
	(In thousands)	
Cash Flow Data:		
Net cash provided by operating activities	$ 147,990	$ 45,465
Net cash provided by investing activities	123,665	76,158

Net cash used in by financing activities	(2,792)	(137,447)

(a) Increase in cash, cash equivalents and short-term investments from December 31, 2004 to December 31, 2005 includes the receipt of a termination fee of $90.5 million received from Inamed upon the termination of the proposed merger with Inamed, net of expenses related to the proposed transaction.

Table of Contents

The following selected consolidated financial data for the five-year period ended June 30, 2005 is derived from our audited consolidated financial statements and accompanying notes. The comparability of the years presented is impacted by certain product rights and business acquisitions and dispositions. All business acquisitions were accounted for under the purchase method and accordingly, the results of operations reflect the financial results of each business acquisition from the date of the acquisition. Certain business acquisitions resulted in the write-off of in-process research and development resulting from an independent valuation. Gross profit does not include amortization of the related intangibles. All share and per share data have been restated to reflect the 2 for 1 stock split effected in the form of a stock dividend that occurred on January 23, 2004.

	Fiscal Year Ended June 30,				
	2005	2004	2003	2002	2001
	(In thousands, except per share amounts)				
Statements of Operations Data:					
Net product revenues	$ 305,114	$ 291,607	$ 241,909	$ 211,248	$ 159,677
Net contract revenues	71,785	12,115	5,630	1,559	8,125
Net revenues	376,899	303,722	247,539	212,807	167,802
Gross profit(a)	321,452	257,116	209,279	177,042	137,105
Operating expenses:					
Selling, general and administrative	135,154(b)	118,253	91,648	77,314	59,508
Research and development	65,676(c)	16,494(d)	29,568(e)	15,132(f)	25,515(g)
In-process research and development				6,217	
Depreciation and amortization	22,350	16,794	10,125	7,928	8,261
Total operating expenses	223,180	151,541	131,341	106,591	93,284
Operating income	98,272	105,575	77,938	70,451	43,821
Other:					
Net interest income (expense)	830	(758)	(278)	8,533	15,504
Loss on early extinguishment of debt		(58,660)			
Income tax expense	(34,112)	(15,317)	(26,404)	(28,960)	(18,905)
Net income	$ 64,990	$ 30,840	$ 51,256	$ 50,024	$ 40,420
Basic net income per share	$ 1.18	$ 0.55	$ 0.94	$ 0.83	$ 0.67
Diluted net income per share	$ 1.01	$ 0.52	$ 0.84	$ 0.79	$ 0.64
Cash dividend declared per common share	$ 0.12	$ 0.10	$ 0.025		

Basic common shares outstanding	55,196	55,618	54,376	60,536	60,268
Diluted common shares outstanding	70,909	72,481	70,191	63,828	63,388

(a) Amounts exclude $19.6 million, $14.9 million, $9.2 million, $7.1 million and $7.6 million for amortization expense related to acquired intangible assets in fiscal 2005, 2004, 2003, 2002 and 2001, respectively.

(b) Includes approximately $5.3 million of business integration planning costs related to the proposed merger with Inamed, and approximately $1.3 million of professional fees related to research and development collaborations with aaiPharma, Ansata and Q-Med.

Table of Contents

(c) Includes approximately $8.3 million paid to aaiPharma related to a research and development collaboration, $5.0 million paid to Ansata related to an exclusive development and license agreement and $30.0 million paid to Q-Med related to an exclusive license agreement for the development of SubQ™.

(d) Includes approximately $2.4 million paid to Dow for a research and development collaboration.

(e) Includes $14.2 million paid to Dow for a research and development collaboration and approximately $6.0 million paid to aaiPharma for a research and development collaboration.

(f) Includes $7.7 million paid to aaiPharma for a research and development collaboration.

(g) Includes $17.0 million paid to Corixa Corporation for a development, commercialization and licensing agreement.

	June 30,				
	2005	2004	2003	2002	2001
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents, restricted cash and short-term investments	$ 603,568	$ 634,040	$ 552,663	$ 577,576	$ 334,157
Working capital	600,070	666,743	576,781	611,259	358,468
Total assets	1,043,251	1,078,384	932,841	876,273	550,007
Long-term debt	453,065	453,067	400,000	400,000	
Stockholders equity	486,346	555,303	461,121	429,059	503,453

	Fiscal Year Ended June 30,				
	2005	2004	2003	2002	2001
	(In thousands)				
Cash Flow Data:					
Net cash provided by operating activities	$ 129,981	$ 127,964	$ 84,667	$ 73,542	$ 71,120
Net cash provided by (used in) investing activities	140,487	(166,341)	(113,709)	(341,660)	(97,981)
Net cash (used in) provided by financing activities	(139,793)	40,621	(23,343)	254,938	12,548

Table of Contents

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) summarizes the significant factors affecting our results of operations, liquidity, capital resources and contractual obligations, as well as discusses our critical accounting policies and estimates. You should read the following discussion and analysis together with our consolidated financial statements, including the related notes, which are included in this report on Form 10-K/T. Certain information contained in the discussion and analysis set forth below and elsewhere in this report, including information with respect to our plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties. See Risk Factors in Item 1A of this Form 10-K/T for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements in this report. Our MD&A is composed of four major sections; Executive Summary, Results of Operations, Liquidity and Capital Resources and Critical Accounting Policies and Estimates.

Change in Fiscal Year

On December 12, 2005, our Board of Directors resolved to change our fiscal year end from June 30 to December 31, effective December 31, 2005. This change was made to align our fiscal year end with other companies within our industry. Our six-month results discussed below relate to the transitional six-month fiscal period ended December 31, 2005 (the Transition Period). We refer to the period beginning July 1, 2004 and ending June 30, 2005 as fiscal 2005 , the period beginning July 1, 2003 and ending June 30, 2004 as fiscal 2004 and the period beginning July 1, 2002 and ending June 30, 2003 as fiscal 2003 .

Executive Summary

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

Our current product lines are divided between the dermatological and non-dermatological fields. Our dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. Our non-dermatological field represents products for the treatment of asthma (until May 2004), urea cycle disorder and contract revenue. Our acne and acne-related dermatological product lines include core brands DYNACIN®, PLEXION® and TRIAZ®. Our non-acne dermatological product lines include core brands LOPROX®, OMNICEF®, RESTYLANE® and VANOS™. Our non-dermatological product lines include AMMONUL®, BUPHENYL® and ORAPRED®. ORAPRED® was one of the Company s core brands until it was licensed to BioMarin in May 2004. Our non-dermatological field also includes contract revenues associated with licensing and authorized generic agreements.

Key Aspects of Our Business

We derive a majority of our prescription volume from our core prescription products: DYNACIN®, LOPROX®, OMNICEF®, PLEXION®, TRIAZ® and VANOS™. We believe that sales of our core prescription products and sales of our dermal aesthetic product, RESTYLANE®, which we began selling in the U.S. on January 6, 2004, will continue to constitute a significant portion of our sales for the foreseeable future.

We have built our business by executing a four-part growth strategy: promoting existing core 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 relation-

Table of Contents

ships of trust and confidence with the high prescribing dermatologists and podiatrists and the leading plastic surgeons in the United States.

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

We estimate customer demand for our prescription products primarily through use of third party syndicated data sources which track prescriptions written by health care providers and dispensed by licensed pharmacies. The data represents extrapolations from information provided only by certain pharmacies and are estimates of historical demand levels. We estimate customer demand for our non-prescription products primarily through internal data that we compile. We observe trends from these data, and, coupled with certain proprietary information, prepare demand forecasts that are the basis for purchase orders for finished and component inventory from our third party manufacturers and suppliers. Our forecasts may fail to accurately anticipate ultimate customer demand for 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. Consistent with pharmaceutical industry patterns, approximately 80% of our revenues are derived from three major drug wholesale concerns. While we attempt to estimate inventory levels of our products at our major wholesale customers by using historical prescription information and historical purchase patterns, this process is inherently imprecise. Rarely do wholesale customers provide us complete inventory levels at regional distribution centers, or within their national distribution systems. We rely wholly upon our wholesale and drug chain customers to effect the distribution allocation of our products. Based upon historically consistent purchasing patterns of our major wholesale customers, we believe our estimates of trade inventory levels of our products are reasonable. We further believe that inventories of our products among wholesale customers, taken as a whole, are similar to those of other specialty pharmaceutical companies, and that our trade practices, which periodically involve volume discounts and early payment discounts, are typical of the industry.

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

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

Table of Contents

As described in more detail below, the following significant events and transactions occurred during the Transition Period, and affected our results of operations, our cash flows and our financial condition:

Termination of the proposed definitive merger agreement with Inamed Corporation;

Adoption of SFAS No. 123R; and

Write-down of a long-lived asset due to impairment.

Termination of the Proposed Definitive Merger Agreement with Inamed Corporation

On March 20, 2005, Medicis and Inamed Corporation (Inamed) entered into an Agreement and Plan of Merger (the Agreement). Inamed is a global healthcare company that develops, manufactures, and markets breast implants for aesthetic augmentation and reconstructive surgery following a mastectomy, a range of dermal products to correct facial wrinkles, the BioEnterics® LAP-BAND® System designed to treat severe and morbid obesity, and the BioEnterics® Intragastric Balloon (BIB®) system for the treatment of obesity. Under the terms of the Agreement, Inamed was to merge with and into a subsidiary of Medicis and each share of Inamed common stock would have been converted into the right to receive 1.4205 shares of Medicis common stock and $30.00 in cash. The completion of the transaction was subject to several customary conditions, including the receipt of applicable approvals from Medicis and Inamed s stockholders, the absence of any material adverse effect on either party s business and the receipt of regulatory approvals.

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, pursuant to which Medicis and Inamed agreed to terminate the Agreement. In accordance with the terms of the Agreement and the merger termination agreement, Inamed paid Medicis a termination fee of $90.0 million, plus $0.5 million in expense reimbursement fees on December 13, 2005.

From the inception of the proposed transaction with Inamed through the termination of the Agreement, we had incurred approximately $14.0 million of professional and other costs related to the transaction. These costs, which were maintained in other long-term assets in our consolidated balance sheet during the transaction approval process, were expensed upon termination of the Agreement. As a result of the termination, we were required to pay Deutsche Bank Trust Company Americas a fee pursuant to a provision in the merger engagement letter with them whereby they were entitled to a portion of the termination fee. We also incurred business integration costs related to the transaction, including the planning for and implementation of integration activities. These costs were expensed as incurred. During the Transition Period, we incurred approximately $4.4 million of business integration planning costs. These costs were primarily consulting and other professional fees.

During the Transition Period, we recognized a net benefit related to the above items of approximately $59.1 million. This is summarized as follows (in millions):

Termination fee received from Inamed, including expense reimbursement fees	$ 90.5
Less:	
Transaction costs expensed, including legal and advisory fees	27.0
Integration planning costs	4.4
	$ 59.1

Approximately $0.7 million of the integration planning costs, incurred during the three months ended September 30, 2005, are included in selling, general and administrative expenses in the accompanying consolidated statements of income. Approximately $59.8 million of the net benefit related to the above items, including $3.7 million of integration planning costs incurred during the three months ended December 31, 2005, is included in other income, net, in the accompanying consolidated statements of income.

The total net benefit we recognized from the inception of the proposed transaction through the termination of the Agreement was approximately $53.8 million. This includes the $59.1 million benefit

Table of Contents

recognized during the Transition Period, partially offset by approximately $5.3 million of integration planning costs incurred during the three months ended June 30, 2005.

Adoption of SFAS No. 123R

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123R), which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Share-based payments include stock option and nonvested share grants. We grant options to purchase common stock to some of our employees and directors under various plans at prices equal to the market value of the stock on the dates the options were granted. We historically have accounted for stock options using the method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB Opinion No. 25) whereby stock options are granted at market price and no compensation cost is recognized, and disclosed the pro forma effect on net earnings assuming compensation cost had been recognized in accordance with SFAS No. 123. SFAS No. 123R, which was effective for us beginning in the first quarter of the Transition Period, eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, and generally requires that such transactions be accounted for using prescribed fair-value-based methods. SFAS No. 123R permits public companies to adopt its requirements using one of two methods: (a) a modified prospective method in which compensation costs are recognized beginning with the effective date based on the requirements of SFAS No. 123R for all share-based payments granted or modified after the effective date, and based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date or (b) a modified retrospective method which includes the requirements of the modified prospective method described above, but also permits companies to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either for all periods presented or prior interim periods of the year of adoption. We decided to adopt SFAS No. 123R using the modified prospective method. SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under historical literature.

During the six months ended December 31, 2005, we recognized approximately $14.9 million (before income tax expense) of compensation expense related to the expensing of stock options and restricted stock in accordance with SFAS No. 123R. Approximately $13.9 million and $1.0 million is included in selling, general and administrative expenses and research and development expenses, respectively, in the accompanying consolidated statements of income. Basic and diluted net income per common share for the Transition Period would have been $1.12 and $0.92, respectively, if the Company had not adopted SFAS No. 123R, compared to reported basic and diluted net income per common share of $0.92 and $0.76, respectively.

Write-down of a Long-lived Asset Due to Impairment

We assess the potential impairment of long-lived assets on a periodic basis and when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Factors that we consider in deciding when to perform an impairment review include significant under-performance of a product line in relation to expectations, significant negative industry or economic trends, and significant changes or planned changes in our use of the assets. Recoverability of assets that will continue to be used in our operations is measured by comparing the carrying amount of the asset grouping to our estimate of the related total future net cash flows. If an asset carrying value is not recoverable through the related cash flows, the asset is considered to be impaired. The impairment is measured by the difference between the asset grouping s carrying amount and its fair value, based on the best information available, including market prices or discounted cash flow analysis.

During the quarter ended December 31, 2005, a long-lived asset related to our DYNACIN® capsule products was determined to be impaired based on our analysis of the long-lived asset s carrying value and projected future cash flows. Factors affecting the long-lived asset s future cash flows included our promotional focus on our DYNACIN® tablet products, and competitive pressures in the marketplace. As a result of the impairment analysis, we recorded a write-down of approximately $9.2 million related to this long-lived asset,

Table of Contents

which is included in selling, general and administrative expenses in the accompanying consolidated statements of income.

Results of Operations

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

	Transition Period(a)	Six Months Ended December 31, 2004(b)	Fiscal Year Ended 2005(c)	2004(d)	2003(e)
		(Unaudited)			
Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Gross profit(f)	85.3	84.9	85.3	84.7	84.5
Operating expenses	75.7	66.8	59.2	49.9	53.1
Operating income	9.6	18.1	26.1	34.8	31.5
Other income, net	36.5				
Interest income (expense), net	2.9	(0.1)	0.2	(0.2)	(0.1)
Loss on early extinguishment of debt				(19.3)	
Income tax expense	(18.7)	(6.3)	(9.1)	(5.0)	(10.7)
Net income	30.3%	11.7%	17.2%	10.2%	20.7%

(a) Included in operating expenses is $14.9 million (9.1%) of net revenues) of compensation expense related to stock options and restricted stock, a charge of approximately $9.2 million (5.6% of net revenues) for the write-down of a long-lived asset, and $0.7 million (0.4% of net revenues) related to integration planning costs incurred during the three months ended September 30, 2005 related to the proposed merger with Inamed. Included in other income, net, is $59.8 million (36.5% of net revenue) related to a termination fee of $90.5 million received from Inamed upon the termination of the proposed merger with Inamed, net of a fee paid to an investment banker and the expensing of accumulated transaction costs of $27.0 million, and integration planning costs incurred during the three months ended December 31, 2005 of $3.7 million.

(b) Included in operating expenses is $5.5 million (3.1% of net revenues) related to our exclusive development and license agreement with Ansata for proprietary technology and $30.7 million (17.0% of net revenues) related to our exclusive license agreement with Q-Med for the development of SubQ^{tm}.

(c) Included in operating expenses is $5.3 million (1.4% of net revenues) of business integration planning costs related to the proposed merger with Inamed, $8.3 million (2.2% of net revenues) related to a research and development collaboration with aaiPharma, $5.5 million (1.5% of net revenues) related to our exclusive development and license agreement with Ansata for proprietary technology and $30.7 million (8.2% of net revenues) related to our exclusive license agreement with Q-Med for the development of SubQ^{tm}.

(d) Included in operating expenses is a $2.4 million payment (0.8% of net revenues) to Dow for a research and development collaboration.

(e)

Included in operating expenses is $14.2 million in payments (5.7% of net revenues) to Dow for a research and development collaboration and a $6.0 million payment (2.4% of net revenues) to aaiPharma for a research and development collaboration.

(f) Gross profit does not include amortization of the related intangibles as such expense is included in operating expenses.

Table of Contents

Six Months Ended December 31, 2005 Compared To Six Months Ended December 31, 2004

Net Revenues

The following table sets forth the net revenues for the Transition Period and December 31, 2004 (the comparable 2004 six months), along with the percentage of net revenues for each of our product categories (amounts in millions):