MEDICIS PHARMACEUTICAL CORP
Form 10-Q
August 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission file number: 001-14471

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of Registrant as specified in its charter)

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

7720 North Dobson Road

Scottsdale, Arizona 85256-2740

(Address of principal executive offices)

(602) 808-8800

(Registrant s telephone number,

including area code)

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

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

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

Large accelerated filer [X]	Accelerated filer [ ]
Non-accelerated filer [ ] (do not check if a smaller reporting company)	Smaller reporting company [ ]

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

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

Class	Outstanding at August 6, 2012
Class A Common Stock $.014 Par Value	59,756,432 (a)

(a) includes 1,992,476 shares of unvested restricted stock awards

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MEDICIS PHARMACEUTICAL CORPORATION

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Part I. Financial Information

Item 1. Financial Statements

MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2012	December 31, 2011
Assets	(unaudited)	
Current assets:		
Cash and cash equivalents	$ 256,094	$ 42,823
Short-term investments	573,525	245,497
Accounts receivable, net	104,269	193,009
Inventories, net	40,427	34,519
Deferred tax assets, net	69,214	12,720
Prepaid income taxes	28,126	1,314
Other current assets	25,544	21,272
Total current assets	1,097,199	551,154
Property and equipment, net	31,443	25,081
Intangible assets, net	471,046	502,492
Goodwill	202,703	202,627
Deferred tax assets, net	61,429	114,555
Long-term investments	22,559	40,270
Other assets	37,111	15,780
	$ 1,923,490	$ 1,451,959

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS, Continued

(in thousands, except share amounts)

	June 30, 2012	December 31, 2011
Liabilities	(unaudited)	
Current liabilities:		
Accounts payable	$ 76,876	$ 54,094
Current portion of long-term debt	181	169,145
Reserve for sales returns	63,920	60,024
Accrued consumer rebates and loyalty programs	81,240	139,948
Managed care and Medicaid reserves	96,252	72,801
Other current liabilities	81,380	78,785
Total current liabilities	399,849	574,797
Long-term liabilities:		
Long-term debt	591,162	181
Other liabilities	51,055	44,998
Stockholders Equity		
Preferred stock, $0.01 par value; shares authorized: 5,000,000; issued and outstanding: none	-	-
Class A common stock, $0.014 par value; shares authorized: 150,000,000; issued and outstanding: 75,952,663 and 74,740,324 at June 30, 2012 and December 31, 2011, respectively	1,037	1,028
Class B common stock, $0.014 par value; shares authorized: 1,000,000; issued and outstanding: none	-	-
Additional paid-in capital	852,661	796,979
Accumulated other comprehensive loss	(19,914)	(21,315)
Accumulated earnings	575,987	567,581
Less: Treasury stock, 18,192,010 and 17,745,039 shares at cost at June 30, 2012 and December 31, 2011, respectively	(528,347)	(512,290)
Total stockholders equity	881,424	831,983
	$ 1,923,490	$ 1,451,959

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Net product revenues	$ 195,092	$ 189,819	$ 395,138	$ 353,715
Net contract revenues	1,462	1,008	3,159	2,025
Net revenues	196,554	190,827	398,297	355,740
Cost of product revenues (1)	21,770	18,237	42,703	32,568
Gross profit	174,784	172,590	355,594	323,172
Operating expenses:				
Selling, general and administrative (2)	101,933	90,393	205,371	175,023
Research and development (3)	23,312	15,195	75,143	29,468
Depreciation and amortization	18,077	7,110	36,157	14,434
Operating income	31,462	59,892	38,923	104,247
Interest and investment income	(560)	(1,238)	(1,173)	(2,512)
Interest expense	4,024	1,141	5,082	2,199
Other expense (income), net	2,900	-	(100)	-
Income from continuing operations before income tax expense	25,098	59,989	35,114	104,560
Income tax expense	10,172	25,477	14,839	43,363
Net income from continuing operations	14,926	34,512	20,275	61,197
Loss from discontinued operations, net of income tax benefit	-	5,729	-	13,054
Net income	$ 14,926	$ 28,783	$ 20,275	$ 48,143
Basic net income per share - continuing operations	$ 0.25	$ 0.55	$ 0.34	$ 0.99
Basic net loss per share - discontinued operations	$ -	$ (0.09)	$ -	$ (0.22)
Basic net income per share	$ 0.25	$ 0.46	$ 0.34	$ 0.78
Diluted net income per share - continuing operations	$ 0.24	$ 0.51	$ 0.33	$ 0.91
Diluted net loss per share - discontinued operations	$ -	$ (0.09)	$ -	$ (0.22)
Diluted net income per share	$ 0.24	$ 0.43	$ 0.33	$ 0.72

Cash dividend declared per common share	$	0.10	$	0.08	$	0.20	$	0.16
Common shares used in calculating:								
Basic net income per share		57,560		60,308		57,549		59,719
Diluted net income per share		63,980		67,140		63,983		66,347
(1) amounts exclude amortization of intangible assets related to acquired products	$	15,676	$	5,266	$	31,352	$	10,718
(2) amounts include share-based compensation expense	$	3,158	$	8,705	$	11,558	$	14,989
(3) amounts include share-based compensation expense	$	(64)	$	615	$	633	$	1,020

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(in thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Net income	$ 14,926	$ 28,783	$ 20,275	$ 48,143
Other comprehensive income, net of income taxes:				
Amortization of prior service costs related to supplemental executive retirement plan	775	256	1,550	256
Establishment of prior service costs for new participants under supplemental executive retirement plan	-	(21,647)	(531)	(21,647)
Net unrealized (loss) gain on available-for-sale securities	(73)	123	331	175
Foreign currency translation adjustment	(135)	(81)	51	67
Total other comprehensive income, net of income taxes	567	(21,349)	1,401	(21,149)
Comprehensive income	$ 15,493	$ 7,434	$ 21,676	$ 26,994

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Six Months Ended	
	June 30, 2012	June 30, 2011
Operating Activities:		
Net income	$ 20,275	$ 48,143
Loss from discontinued operations, net of income tax benefit	-	13,054
Net income from continuing operations	20,275	61,197
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	36,157	14,434
Amortization of prior service costs, supplemental executive retirement plan	2,419	400
Amortization of discount on long-term debt	1,750	-
Amortization of debt issuance costs	296	-
Gain on sale of product rights	(3,000)	-
Charge reducing value of investment in a third party entity	2,900	-
Net gain on sale of available-for-sale investments and supplemental executive retirement plan investments, net	(111)	(27)
Share-based compensation expense	12,191	16,009
Deferred income tax (benefit)	(3,137)	(877)
Tax benefit from exercise of stock options and vesting of restricted stock awards	1,153	1,864
Excess tax benefits from share-based payment arrangements	(4,647)	(2,872)
(Decrease) increase in provision for sales discounts and chargebacks	(1,865)	1,163
Net amortization (accretion) of premium (discount) on investments	1,071	2,604
Changes in operating assets and liabilities:		
Accounts receivable	90,605	(36,940)
Inventories	(5,908)	4,453
Prepaid income taxes	(26,812)	(395)
Other current assets	(4,271)	(3,600)
Accounts payable	20,683	4,378
Reserve for sales returns	3,896	17,528
Accrued consumer rebates and loyalty programs	(58,708)	23,244
Managed care and Medicaid reserves	23,451	1,863
Income taxes payable	-	(4,628)
Other current liabilities	(6,473)	(12,607)
Other liabilities	5,228	128
Net cash provided by operating activities from continuing operations	107,143	87,319
Net cash used in operating activities from discontinued operations	-	(9,978)
Net cash provided by operating activities	107,143	77,341
Investing Activities:		
Purchase of property and equipment	(8,942)	(2,834)
Payments for purchase of product rights	(109)	(12,824)
Proceeds from sale of product rights	6,000	-
Purchase of investments for supplemental executive retirement plan	(12,512)	-
Purchase of available-for-sale investments	(418,191)	(474,810)

Sale of available-for-sale investments	58,371	112,379
Maturity of available-for-sale investments	49,019	188,865
Net cash used in investing activities	(326,364)	(189,224)
Financing Activities:		
Payment of dividends	(10,606)	(8,535)
Proceeds from issuance of long-term debt	500,000	-
Purchase of hedge related to long-term debt	(80,000)	-
Proceeds from sale of warrants related to long-term debt	35,150	-
Payment of debt issuance costs	(14,239)	-
Payment of principal of long-term debt	(3)	-
Withholding of common shares for tax obligations on vested restricted stock awards	(16,057)	(4,731)
Excess tax benefits from share-based payment arrangements	4,647	2,872
Proceeds from the exercise of stock options	13,549	54,049
Net cash provided by financing activities	432,441	43,655
Effect of exchange rate on cash and cash equivalents	51	67
Net increase (decrease) in cash and cash equivalents	213,271	(68,161)
Cash and cash equivalents at beginning of period	42,823	218,362
Cash and cash equivalents at end of period	$ 256,094	$ 150,201

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

(unaudited)

1. NATURE OF BUSINESS

Medicis Pharmaceutical Corporation (Medicis or the Company) is a leading specialty pharmaceutical company focusing primarily on helping patients attain a healthy and youthful appearance and self-image through the development and marketing in the United States (U.S.) and Canada of products for the treatment of dermatological and aesthetic conditions.

The Company offers a broad range of products addressing various conditions or aesthetic improvements including facial wrinkles, glabellar lines, acne, fungal infections, hyperpigmentation, photoaging, psoriasis, actinic keratosis, bronchospasms, external genital and perianal warts/condyloma acuminate, seborrheic dermatitis and cosmesis (improvement in the texture and appearance of skin). Medicis currently offers 29 branded products. Its primary brands are DYSPORT®, PERLANE®, RESTYLANE®, SOLODYN®, VANOS®, ZIANA® and ZYCLARA®.

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

The accompanying interim condensed consolidated financial statements of Medicis have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. The financial information is unaudited, but reflects all adjustments, consisting only of normal recurring adjustments and accruals, which are, in the opinion of the Company s management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

2. DISCONTINUED OPERATIONS

On February 25, 2011, the Company announced that as a result of the Company s strategic planning process and the existing regulatory and commercial capital equipment environment, the Company would explore strategic alternatives for its LipoSonix business including, but not limited to, the sale of the stand-alone business. As a result of this decision, the Company classified the LipoSonix business as a discontinued operation for consolidated financial statement reporting purposes. On November 1, 2011, the Company sold LipoSonix to Solta Medical, Inc.

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The following is a summary of loss from discontinued operations, net of income tax benefit, for the three and six months ended June 30, 2011 (in thousands):

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Net revenues	$ 200	$ 356
Cost of revenues	82	2,456
Gross profit	118	(2,100)
Operating expenses:		
Selling, general and administrative	5,731	11,594
Research and development	3,302	6,648
Loss from discontinued operations before income tax benefit	(8,915)	(20,342)
Income tax benefit	(3,186)	(7,288)
Loss from discontinued operations, net of income tax benefit	$ (5,729)	$ (13,054)

The Company included only revenues and costs directly attributable to the discontinued operations, and not those attributable to the ongoing entity. Accordingly, no interest expense or general corporate overhead costs were allocated to the LipoSonix discontinued operations. Included in cost of revenues for the six months ended June 30, 2011 was a $1.9 million charge related to an increase in the valuation reserve for LipoSonix inventory that was not expected to be sold.

The following is a summary of net cash used in operating activities from discontinued operations for the six months ended June 30, 2011 (in thousands):

	Six Months Ended June 30, 2011
Loss from discontinued operations, net of income tax benefit	$ (13,054)
Share-based compensation expense	1,795
Decrease in assets held for sale from discontinued operations	2,879
Decrease in liabilities held for sale from discontinued operations	(1,598)
Net cash used in operating activities from discontinued operations	$ (9,978)

3. SHARE-BASED COMPENSATION

At June 30, 2012, the Company had seven active share-based employee compensation plans. Of these seven share-based compensation plans, only the 2006 Incentive Award Plan is eligible for the granting of future awards.

Stock Option Awards

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

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The total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of June 30, 2012, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to June 30, 2012, was approximately $1.5 million and the related weighted average period over which it is expected to be recognized is approximately 2.5 years.

A summary of stock option activity within the Company s stock-based compensation plans and changes for the six months ended June 30, 2012, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2011	4,101,505	$ 31.31		
Granted	88,818	$ 36.72		
Exercised	(619,185)	$ 22.47		
Terminated/expired	(58,348)	$ 38.28		
Balance at June 30, 2012	3,512,790	$ 32.88	2.3	$ 11,322,820

The intrinsic value of options exercised during the six months ended June 30, 2012 was approximately $8.7 million. Options exercisable under the Company s share-based compensation plans at June 30, 2012 were 3,340,931 with a weighted average exercise price of $33.06, a weighted average remaining contractual term of 2.1 years, and an aggregate intrinsic value of approximately $10.3 million.

A summary of outstanding and exercisable stock options that are fully vested and are expected to vest, based on historical forfeiture rates, as of June 30, 2012, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, net of expected forfeitures	3,339,865	$ 32.95	2.3	$ 10,518,196
Exercisable, net of expected forfeitures	3,210,396	$ 33.02	2.1	$ 9,924,196

The fair value of each stock option award is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Expected dividend yield	1.06% to 1.14%	0.77% to 0.88%
Expected stock price volatility	0.31 to 0.32	0.33
Risk-free interest rate	1.13% to 1.19%	2.47% to 2.81%
Expected life of options	6.0 to 7.0 Years	7.0 Years

The expected dividend yield is based on expected annual dividends to be paid by the Company as a percentage of the market value of the Company s stock as of the date of grant. The Company determined that a blend of implied volatility and historical volatility is more reflective of market conditions and a better indicator of expected volatility than

using purely historical volatility. The risk-free interest rate is based on the U.S. treasury security rate in effect as of the date of grant whose term is consistent with the expected life of the related grant. The expected lives of the options are based on the Company s historical exercise data.

The weighted average fair value of stock options granted during the six months ended June 30, 2012 and 2011, was $10.77 and $12.25, respectively.

Restricted Stock Awards

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company s Class A common stock on the date of grant, and the total value of the award is expensed ratably over the service period of the employees receiving the grants. As of June 30, 2012, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to June 30, 2012, was approximately $47.4 million, and the related weighted average period over which it is expected to be recognized is approximately 3.5 years.

A summary of restricted stock activity within the Company s share-based compensation plans and changes for the six months ended June 30, 2012, is as follows:

Nonvested Shares	Shares	Weighted Average Grant-Date Fair Value
Nonvested at December 31, 2011	1,919,462	$ 22.61
Granted	705,807	$ 35.01
Vested	(585,722)	$ 20.54
Forfeited	(31,349)	$ 30.81
Nonvested at June 30, 2012	2,008,198	$ 27.44

The total fair value of restricted shares vested during the six months ended June 30, 2012 and 2011 was approximately $12.0 million and $8.5 million, respectively.

Stock Appreciation Rights

During 2009, the Company began granting cash-settled stock appreciation rights (SARs) to many of its employees. SARs generally vest over a graduated five-year period and expire seven years from the date of grant, unless such expiration occurs sooner due to the employee s termination of employment, as provided in the applicable SAR award agreement. SARs allow the holder to receive cash (less applicable tax withholding) upon the holder s exercise, equal to the excess, if any, of the market price of the Company s Class A common stock on the exercise date over the exercise price, multiplied by the number of shares relating to the SAR with respect to which the SAR is exercised. The exercise price of the SAR is the fair market value of a share of the Company s Class A common stock relating to the SAR on the date of grant. The total value of the SAR is expensed over the service period of the employee receiving the grant, and a liability is recognized in the Company s condensed consolidated balance sheets until settled. The fair value of SARs is required to be remeasured at the end of each reporting period until the award is settled, and changes in fair value must be recognized as compensation expense to the extent of vesting during each reporting period based on the new fair value. As of June 30, 2012, the total measured amount of unrecognized compensation cost related to outstanding SARs, to be recognized as expense subsequent to June 30, 2012, based on the remeasurement at June 30, 2012, was approximately $17.8 million, and the related weighted average period over which it is expected to be recognized is approximately 2.3 years.

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

	Remeasurement as of June 30, 2012	SARs Granted During the Six Months Ended June 30, 2011
Expected dividend yield	1.17%	0.87%
Expected stock price volatility	0.31	0.32
Risk-free interest rate	0.41% to 0.72%	3.12%
Expected life of SARs	2.7 to 4.6 Years	7.0 Years

No SARs were granted during the six months ended June 30, 2012. The weighted average fair value of SARs granted during the six months ended June 30, 2011, as of the grant date, was $9.90. The weighted average fair value of all SARs outstanding as of the remeasurement date of June 30, 2012 was $16.77.

A summary of SARs activity for the six months ended June 30, 2012 is as follows:

	Number of SARs	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2011	2,323,060	$ 17.52		
Granted	-	$ -		
Exercised	(295,877)	$ 14.65		
Terminated/expired	(82,983)	$ 17.55		
Balance at June 30, 2012	1,944,200	$ 17.96	4.3	$ 31,484,679

The intrinsic value of SARs exercised during the six months ended June 30, 2012 was approximately $6.3 million.

As of June 30, 2012, 175,195 SARs were exercisable, with a weighted average exercise price of $16.75, a weighted average remaining contractual term of 4.2 years, and an aggregate intrinsic value of approximately $3.0 million.

Total share-based compensation expense related to continuing operations recognized during the three and six months ended June 30, 2012 and 2011 was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Stock options	$ 209	$ 234	$ 404	$ 484
Restricted stock awards	3,364	3,197	6,983	5,799
Stock appreciation rights	(479)	5,889	4,804	9,726
Total share-based compensation expense	$ 3,094	$ 9,320	$ 12,191	$ 16,009

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4. SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

On June 24, 2011, the Company s Compensation Committee adopted the Medicis Pharmaceutical Corporation Supplemental Executive Retirement Plan, as amended on October 3, 2011 (the SERP), a non-qualified, noncontributory, defined benefit pension plan that provides supplemental retirement income for a select group of officers, including the Company s named executive officers. The SERP became effective as of June 1, 2011. Retirement benefits are calculated based on a percentage of a SERP participant s average earnings, which ranges from 1.25% to 10% of the participant s base salary plus cash bonus or incentive payments during any three calendar years of service, regardless of whether the years are consecutive, beginning with the 2009 calendar year. The percentage of average earnings is multiplied by the participant s years of service up to a specified cap on service ranging from five to twenty years. In no event will an executive officer s retirement benefit exceed 50% of his or her average earnings, and for those participants who are not executive officers, their retirement benefits will not exceed 25% of average earnings. The SERP retirement benefit is intended to be paid to participants who reach the normal retirement date, which is age 65, or age 59½ with twenty years of service, subject to certain exceptions.

A SERP participant vests in 1/6th of his or her retirement benefit per plan year, (which runs from June 1 to May 31), effective as of the first day of the plan year, and becomes fully vested in his or her accrued retirement benefit upon (1) the participant s normal retirement date, provided that the participant has at least fifteen years of service with the Company and is employed by the Company on such date, (2) the participant s separation from service due to a discharge without cause or resignation for good reason (as such terms are defined in the participant s employment agreement, or in the absence of such employment agreement or definitions, in the Company s Executive Retention Plan), or (3) a change in control of the Company.

Participants in the SERP received credit for prior service with the Company. The prior service accrued benefit of approximately $33.8 million was recorded during the three months ended June 30, 2011 as other comprehensive income within stockholders equity, and is amortized as compensation expense over the remaining service years of each participant. The Company also established a deferred tax asset of approximately $12.0 million, the benefit of which was also recorded in other comprehensive income. During the three months ended March 31, 2012, an additional participant was added to the plan, and a prior service accrued benefit of approximately $0.8 million was recorded as other comprehensive income within stockholders equity, and is being amortized over the remaining service years of the participant. Total amortization of prior service costs recognized as compensation expense during the three and six months ended June 30, 2012, was approximately $1.2 million and $2.4 million, respectively. Amortization of prior service costs recognized as compensation expense during the three months ended June 30, 2011, was approximately $0.4 million, representing one month of amortization.

Compensation expense recognized during the three and six months ended June 30, 2012 related to current service costs was approximately $0.3 million and $0.5 million, respectively. Interest cost accrued related to prior and current service costs during the three and six months ended June 30, 2012 was approximately $0.4 million and $0.8 million, respectively. The total present value of accrued benefits for the SERP as of June 30, 2012 was approximately $37.1 million, which is included in other long-term liabilities in the Company s condensed consolidated balance sheets as of June 30, 2012.

The Company maintains a rabbi trust to fund the SERP benefit. During the three months ended September 30, 2011 and three months ended June 30, 2012, the Company purchased life insurance policy investments of approximately $9.8 million and $12.1 million, respectively, to fund the SERP. The life insurance policies cover the SERP participants. The Company intends to make similar annual purchases during each of the next three years. During the three months ended March 31, 2012, the Company made an additional life insurance policy investment purchase of approximately $0.4 million related to the new participant added to the SERP during such time. No material net gains on the investments were recognized during the three or six months ended June 30, 2012. The Company s expected return on the plan assets is 4%. The total investment related to the SERP of $22.4 million is included in other assets in the Company s condensed consolidated balance sheets as of June 30, 2012, and is the cash surrender value of the life insurance policies, representing the fair value of the plan assets.

5. SHORT-TERM AND LONG-TERM INVESTMENTS

The Company s policy for its short-term and long-term investments is to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company s investment guidelines and market conditions. Short-term and long-term investments

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consist of corporate and various government agency and municipal debt securities. The Company s investments in auction rate floating securities consist of investments in student loans. Management classifies the Company s short-term and long-term investments as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses reported in stockholders equity. Realized gains and losses and declines in value judged to be other than temporary, if any, are included in other expense in the condensed consolidated statement of operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary, results in impairment of the fair value of the investment. Except for impairments related to the illiquidity of the Company s auction rate floating securities, other-than-temporary impairments are charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security. Dividends and interest income are recognized when earned. The cost of securities sold is calculated using the specific identification method. At June 30, 2012, the Company has recorded the estimated fair value of available-for-sale securities in short-term and long-term investments of approximately $573.5 million and $22.6 million, respectively.

Available-for-sale securities consist of the following at June 30, 2012 (in thousands):

	June 30, 2012				
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-Than-Temporary Impairment Losses	Fair Value
Corporate notes and bonds	$ 299,940	$ 338	$ (212)	$ -	$ 300,066
Federal agency notes and bonds	236,684	220	(59)	-	236,845
Auction rate floating securities	17,350	-	(4,584)	-	12,766
Asset-backed securities	46,400	21	(14)	-	46,407
Total securities	$ 600,374	$ 579	$ (4,869)	$ -	$ 596,084

	December 31, 2011				
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-Than-Temporary Impairment Losses	Fair Value
Corporate notes and bonds	$ 138,554	$ 161	$ (549)	$ -	$ 138,166
Federal agency notes and bonds	125,092	221	(24)	-	125,289
Auction rate floating securities	17,400	-	(4,607)	-	12,793
Asset-backed securities	9,527	-	(8)	-	9,519
Total securities	$ 290,573	$ 382	$ (5,188)	$ -	$ 285,767

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During the six months ended June 30, 2012, gross realized gains on sales of available-for-sale securities totaled approximately $0.1 million. During the three and six months ended June 30, 2012, there were no significant gross realized losses on sales of available-for-sale securities. During the three and six months ended June 30, 2011, there were no significant gross realized gains or losses on sales of available-for-sale securities. Gross unrealized gains and losses are determined based on the specific identification method. The net adjustment to unrealized losses during the six months ended June 30, 2012, on available-for-sale securities included in stockholders equity totaled approximately $0.3 million. The amortized cost and estimated fair value of the available-for-sale securities at June 30, 2012, by maturity, are shown below (in thousands):

	June 30, 2012	
	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	$ 261,275	$ 261,399
Due after one year through five years	321,749	321,919
Due after 10 years	17,350	12,766
	$ 600,374	$ 596,084

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations. At June 30, 2012, approximately $22.6 million in estimated fair value expected to mature greater than one year has been classified as long-term investments since these investments are in an unrealized loss position, and management has both the ability and intent to hold these investments until recovery of fair value, which may be maturity.

As of June 30, 2012, the Company s investments included auction rate floating securities with a fair value of $12.8 million. The Company s auction rate floating securities are debt instruments with a long-term maturity and with an interest rate that is reset in short intervals through auctions. The negative conditions in the credit markets from 2008 through the first six months of 2012 have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008, the Company was informed that there was insufficient demand at auction for the auction rate floating securities. As a result, these affected auction rate floating securities are now considered illiquid, and the Company could be required to hold them until they are redeemed by the holder at maturity. The Company may not be able to liquidate the securities until a future auction on these investments is successful.

The following table shows the gross unrealized losses and the fair value of the Company s investments, with unrealized losses that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2012 (in thousands):

	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Corporate notes and bonds	$ 144,330	$ (170)	$ 1,958	$ (42)
Federal agency notes and bonds	136,641	(59)	-	-
Auction rate floating securities	-	-	12,766	(4,584)
Asset-backed securities	16,267	(14)	-	-

Total securities	$	297,238	$	(243)	$	14,724	$	(4,626)

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As of June 30, 2012, the Company has concluded that the unrealized losses on its investment securities are temporary in nature and are caused by changes in credit spreads and liquidity issues in the marketplace. Available-for-sale securities are reviewed quarterly for possible other-than-temporary impairment. This review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the expectation for that security s performance and the creditworthiness of the issuer. Additionally, the Company does not intend to sell and it is not more-likely-than-not that the Company will be required to sell any of the securities before the recovery of their amortized cost basis.

6. FAIR VALUE MEASUREMENTS

As of June 30, 2012, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included the Company s short-term and long-term investments, including investments in auction rate floating securities.

The Company has invested in auction rate floating securities, which are classified as available-for-sale securities and reflected at fair value. Due to events in credit markets, the auction events for some of these instruments held by the Company failed during the three months ended March 31, 2008 (See Note 5). Therefore, the fair values of these auction rate floating securities, which are primarily rated AAA, are estimated utilizing a discounted cash flow analysis as of June 30, 2012. These analyses consider, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These investments were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company. Changes to these assumptions in future periods could result in additional declines in fair value of the auction rate floating securities.

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The Company s assets measured at fair value on a recurring basis subject to the disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, at June 30, 2012 and December 31, 2011, were as follows (in thousands):

		Fair Value Measurement at Reporting Date Using		
	June 30, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate notes and bonds	$ 300,066	$ -	$ 300,066	$ -
Federal agency notes and bonds	236,845	-	236,845	-
Auction rate floating securities	12,766	-	-	12,766
Asset-backed securities	46,407	-	46,407	-
Total assets measured at fair value	$ 596,084	$ -	$ 583,318	$ 12,766

		Fair Value Measurement at Reporting Date Using		
	Dec. 31, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate notes and bonds	$ 138,166	$ -	$ 138,166	$ -
Federal agency notes and bonds	125,289	-	125,289	-
Auction rate floating securities	12,793	-	-	12,793
Asset-backed securities	9,519	-	9,519	-
Total assets measured at fair value	$ 285,767	$ -	$ 272,974	$ 12,793

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The following tables present the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2012 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Floating Securities
Balance at March 31, 2012	$ 12,754
Transfers to (from) Level 3	-
Total gains (losses) included in other (income) expense, net	-
Total gains included in other comprehensive income	12
Purchases	-
Settlements	-
Balance at June 30, 2012	$ 12,766

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Floating Securities
Balance at December 31, 2011	$ 12,793
Transfers to (from) Level 3	-
Total gains (losses) included in other (income) expense, net	-
Total gains included in other comprehensive income	23
Purchases	-
Settlements	(50)
Balance at June 30, 2012	$ 12,766

The following is a description of the valuation techniques used for the assets measured at fair value classified within Level 2 or Level 3 of the fair value hierarchy:

Available-for-sale securities classified within Level 2 of the fair value hierarchy are valued utilizing reports from third-party asset managers that hold the Company s investments, showing closing prices on the last business day of the period presented. These asset managers utilize an independent pricing source to obtain quotes for most fixed income securities, and utilize internal procedures to validate the prices obtained. In addition, the Company uses an independent third-party to perform price testing, comparing a sample of quoted prices listed in the asset managers reports to quotes listed through a public quotation service.

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Available-for-sale securities classified within Level 3 of the fair value hierarchy (auction rate floating securities) are valued utilizing a discounted cash flow model. Key variables that are included in the Company s calculation of the fair value of its auction rate floating securities utilizing a discounted cash flow model are weighted average cost of capital (WACC), liquidity horizon and estimated coupon rate. The liquidity horizon is an estimation of how long the liquidity issue of the auction rate floating securities will continue to exist. As part of its calculation of the fair value of its auction rate floating securities as of June 30, 2012, the Company used a WACC of 5.0%, a liquidity horizon of nine years, and an estimated coupon rate of a 12-month historical average for the indexes. The 12-month historical averages for 1-Month LIBOR and 90-Day T-Bills were 0.24% and 0.04%, respectively. As part of its assessment of these variables used in calculating the fair value of its auction rate floating securities, the Company performs a sensitivity analysis to understand the potential impact of using different amounts for these variables. As of June 30, 2012, the sensitivity analysis did not produce calculated fair values that were significantly different from those calculated using the variables described above.

7. RESEARCH AND DEVELOPMENT

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

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

Research and development expense for the three and six months ended June 30, 2012 and 2011 are as follows (in thousands):

	Three Months Ended		**Six Months Ended**	
	June 30, 2012	**June 30, 2011**	**June 30, 2012**	**June 30, 2011**
Ongoing research and development costs	$ 15,376	$ 7,080	$ 27,504	$ 13,948
Payments related to strategic collaborations	8,000	7,500	47,006	14,500
Share-based compensation expense	(64)	615	633	1,020
Total research and development	$ 23,312	$ 15,195	$ 75,143	$ 29,468

8. STRATEGIC COLLABORATIONS

Development and License Agreement with a specialty pharmaceutical company

On March 30, 2012, the Company entered into a Development and License Agreement with a specialty pharmaceutical company pursuant to which the Company obtained exclusive worldwide rights for the development and commercialization of an investigational drug targeted at certain topical skin applications. Under the terms of the agreement, the Company agreed to pay an up-front payment of $25.0 million in connection with the execution of the agreement, and will pay up to an additional $80.0 million upon the achievement of certain research, development and regulatory milestones and up to an additional $120.0 million upon the achievement of certain commercial milestones, as well as royalties on future sales. The initial $25.0 million up-front payment, which was paid in April 2012, was recognized as research and development expense during the three months ended March 31, 2012.

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License Agreement with 3M

On February 24, 2012, the Company entered into a License Agreement with 3M Company and 3M Innovative Properties Company (collectively, 3M) for worldwide rights to a number of leading molecules in 3M s platform of immune response modifiers, for all topical dermatology indications and options for all human uses associated with the licensed molecules, excluding vaccine adjuvant. Under the terms of the agreement, the Company made an up-front payment of $7.5 million to 3M in connection with the execution of the agreement, and will pay up to an additional $25.6 million of contingent license and option fees. The Company may also pay up to an additional $25.0 million upon the achievement of certain research, development and regulatory milestones, as well as royalties on future sales. The initial $7.5 million payment was recognized as research and development expense during the three months ended March 31, 2012.

Joint Development Agreement with Lupin

On July 21, 2011, the Company entered into a Joint Development Agreement (the Original Agreement) with Lupin Limited, on behalf of itself and its affiliates (hereinafter collectively referred to as Lupin), whereby the Company and Lupin will collaborate to develop multiple novel proprietary therapeutic products. Pursuant to the Original Agreement, subject to the terms and conditions contained therein, the Company made an up-front $20.0 million payment to Lupin and was to make additional payments to Lupin upon the achievement of certain research, development, regulatory and other milestones, as well as royalty payments on sales of the products covered under the Original Agreement. In addition, the Company was to receive an exclusive, worldwide (excluding India) license on the sale of the products covered under the Original Agreement.

On March 30, 2012, the Company entered into an Amended and Restated Joint Development Agreement, with Lupin (the Amended and Restated Joint Development Agreement), which modified the list of products being developed. The Company made a $2.5 million payment to Lupin in April 2012 in connection with the execution of the Amended and Restated Joint Development Agreement, and will make additional payments to Lupin of up to $35.5 million upon the achievement of certain research, development, regulatory and other milestones, as well as royalty payments on sales of the products covered under the Amended and Restated Joint Development Agreement, which supersedes the additional payments the Company would have made under the Original Agreement. In addition, the Company will receive an exclusive, worldwide (excluding India) license on the sale of the products covered under the Amended and Restated Joint Development Agreement.

The $20.0 million up-front payment related to the Original Agreement was recognized as research and development expense during the three months ended September 30, 2011. The $2.5 million payment related to the Amended and Restated Joint Development Agreement was recognized as research and development expense during the three months ended March 31, 2012.

Amended and Restated Collaboration Agreement and Asset Purchase Agreement with Hyperion

On March 22, 2012, Ucyclyd Pharma, Inc. (Ucyclyd), a wholly-owned subsidiary of the Company, and Hyperion Therapeutics, Inc. (Hyperion) entered into an Amended and Restated Collaboration Agreement (the Amended Collaboration Agreement), which amended and restated their existing Collaboration Agreement, dated August 23, 2007, as previously amended on or about November 24, 2008, June 29, 2009 and October 12, 2009 (the Prior Collaboration Agreement).

Pursuant to the terms of the Prior Collaboration Agreement, Ucyclyd granted rights to Hyperion, exercisable in the future, to purchase certain worldwide rights to Ucyclyd s existing on-market products AMMONUL® and BUPHENYL® under certain conditions, as well as to develop and commercialize Ravicti , a compound referred to as HPN-100 (and also previously referred to as GT4P in the Prior Collaboration Agreement), for the treatment of urea cycle disorder, hepatic encephalopathies and other indications. The parties agreed to supersede the Prior Collaboration Agreement with the Amended Collaboration Agreement, under which Hyperion will continue to have the right, exercisable no earlier than January 1, 2013, to purchase certain worldwide rights to AMMONUL® and BUPHENYL®, subject to Ucyclyd s right to elect to retain such rights to AMMONUL®, and an Asset Purchase Agreement of even date (the APA), under which Hyperion agreed to purchase Ucyclyd s rights to Ravicti on the terms set forth therein. The parties completed the sale of Ravicti under the APA on March 22, 2012, for which Hyperion paid Ucyclyd $6.0 million. If Ravicti is not approved by the FDA by January 1, 2013, Ucyclyd will pay Hyperion $0.5 million per month until June 30, 2013, or until Ravicti is approved, whichever comes first, subject to a maximum of $3.0 million in aggregate payments. Pursuant to the APA, Hyperion will pay Ucyclyd certain royalties and regulatory and sales milestones relating to Ravicti and, pursuant to the terms of the Amended Collaboration Agreement, following exercise of its purchase rights, Hyperion will pay Ucyclyd certain royalties and regulatory and sales milestones relating to AMMONUL® (but only if Ucyclyd does not elect to retain rights to AMMUNOL®) and BUPHENYL®. Ucyclyd will continue to be entitled to all revenue from the sales of AMMONUL® and BUPHENYL® until the exercise of the purchase rights by Hyperion. If Hyperion elects to purchase AMMONUL® and BUPHENYL®, but Ucyclyd elects to retain AMMONUL®, then AMMONUL® will remain an asset of Ucyclyd and Ucyclyd will continue to be entitled to all revenue from the sales of AMMONUL®. A net gain of $3.0 million on the sale of Ravicti to Hyperion was recognized in other income during the three months ended March 31, 2012. This consisted of the $6.0 million payment Ucyclyd received from Hyperion, partially offset by the $3.0 million in total potential contingent payments that Ucyclyd could pay to Hyperion during the first six months of 2013, based upon the timing of the approval of Ravicti by the FDA. The $3.0 million contingent liability is included in other current liabilities in the Company s condensed consolidated balance sheets as of June 30, 2012.

Collaboration with a privately-held U.S. biotechnology company

On September 10, 2010, the Company and a privately-held U.S. biotechnology company entered into a sublicense and development agreement to develop an agent for specific dermatological conditions in the Americas and Europe and a purchase option to acquire the privately-held U.S. biotechnology company.

Under the terms of the agreements, the Company paid the privately-held U.S. biotechnology company $5.0 million in connection with the execution of the agreement, and will pay additional potential milestone payments totaling approximately $100.5 million upon successful completion of certain clinical, regulatory and commercial milestones.

During the three months ended December 31, 2010 and June 30, 2011, development milestones were achieved, and the Company made a $10.0 million and a $5.5 million payment, respectively, pursuant to the agreements. The initial $5.0 million payment and the $10.0 million milestone payment were recognized as research and development expense during 2010, and the $5.5 million milestone payment was recognized as research and development expense during the three months ended June 30, 2011. As of June 30, 2012, $75.0 million of potential milestone payments upon successful completion of certain clinical, regulatory and commercial milestones remain.

Research and Development Agreement with Anacor

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

9. SEGMENT AND PRODUCT INFORMATION

The Company operates in one business segment: pharmaceuticals. The Company s current pharmaceutical franchises are divided between the dermatological and non-dermatological fields. The dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. The non-dermatological field represents products for the treatment of urea cycle disorder, contract revenue, and beginning on December 2, 2011, upon the Company s acquisition of the assets of Graceway Pharmaceuticals, LLC (Graceway), products in the respiratory and women s health specialties. The acne and acne-related dermatological product lines include SOLODYN® and ZIANA®. During early 2011, the Company discontinued its TRIAZ® branded products and decided to no longer promote its PLEXION® branded products. The non-acne dermatological product lines include DYSPORT®, LOPROX®, PERLANE®, RESTYLANE®, VANOS® and ZYCLARA®. ZYCLARA® was acquired by the Company as part of the acquisition of the assets of Graceway on December 2, 2011. The non-dermatological product lines include AMMONUL®, BUPHENYL® and the MAXAIR® AUTOHALER®. The MAXAIR® AUTOHALER® was acquired by the Company as part of the acquisition of the assets of Graceway on December 2, 2011. The non-dermatological field also includes contract revenues associated with licensing agreements and authorized generic agreements.

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The Company s pharmaceutical products, with the exception of AMMONUL® and BUPHENYL®, are promoted to dermatologists and plastic surgeons. Such products are often prescribed by physicians outside these two specialties, including family practitioners, general practitioners, primary-care physicians and OB/GYNs, as well as hospitals, government agencies and others. ZIANA® and SOLODYN® are also promoted to pediatricians whose prescribing habits closely resemble those of dermatologists. Currently, the Company s products are sold primarily to wholesalers and retail chain drug stores.

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

	Three Months Ended		**Six Months Ended**	
	June 30, 2012	**June 30, 2011**	**June 30, 2012**	**June 30, 2011**
Acne and acne-related dermatological products	$ 93,131	$ 123,130	$ 201,632	$ 226,592
Non-acne dermatological products	81,113	57,719	155,112	109,940
Non-dermatological products	22,310	9,978	41,553	19,208
Total net revenues	$ 196,554	$ 190,827	$ 398,297	$ 355,740

	Three Months Ended		**Six Months Ended**	
	June 30,	**June 30,**	**June 30,**	**June 30,**
	2012	2011	2012	2011
Acne and acne-related dermatological products	48 %	65 %	51 %	64 %
Non-acne dermatological products	41	30	39	31
Non-dermatological products	11	5	10	5
Total net revenues	100 %	100 %	100 %	100 %

During the three and six months ended June 30, 2012, approximately 5.3% and 5.1% of the Company s net revenues were generated in Canada. No country or region outside of the U.S. and Canada generated more than 5%, individually or in the aggregate, of the Company s net revenues during the three or six months ended June 30, 2012. During the three and six months ended June 30, 2011, less than 5% of the Company s net revenues were generated outside of the U.S.

10. INVENTORIES

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

Inventory costs associated with products that have not yet received regulatory approval are capitalized if, in the view of the Company s management, there is probable future commercial use and future economic benefit. If future commercial use and future economic benefit are not considered probable, then costs associated with pre-launch inventory that has not yet received regulatory approval are expensed as research and development expense during the period the costs are incurred. As of June 30, 2012 and December 31, 2011, there were no costs capitalized into inventory for products that had not yet received regulatory approval.

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Inventories as of June 30, 2012 and December 31, 2011 is comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
Raw materials	$ 11,752	$ 9,100
Work-in-process	1,148	5,495
Finished goods	31,572	29,250
Valuation reserve	(4,045)	(9,326)
Total inventories	$ 40,427	$ 34,519

11. OTHER CURRENT LIABILITIES

Other current liabilities as of June 30, 2012 and December 31, 2011 is comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
Accrued incentives, including SARs liability	$ 33,331	$ 41,516
Deferred revenue	17,129	13,703
Other accrued expenses	30,920	23,566
	$ 81,380	$ 78,785

Deferred revenue as of June 30, 2012 and December 31, 2011 is comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
Deferred revenue - aesthetics products, net of cost of revenue	$ 8,917	$ 13,349
Deferred revenue - sales into distribution channel in excess of eight weeks of projected demand	8,070	212
Other deferred revenue	142	142
	$ 17,129	$ 13,703

The Company defers revenue, and the related cost of revenue, of its aesthetics products, including DYSPORT®, PERLANE® and RESTYLANE®, until its exclusive U.S. distributor ships the product to physicians. The Company also defers the recognition of revenue for certain sales of inventory into the distribution channel that are in excess of eight (8) weeks of projected demand. The increase in deferred revenue for units in the distribution channel in excess of eight weeks of projected demand during the six months ended June 30, 2012 was primarily associated with units of SOLODYN® and ZYCLARA®.

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12. LONG-TERM DEBT

Long-term debt as of June 30, 2012 and December 31, 2011 is comprised of the following (in thousands):

	June 30, 2012	December 31, 2011
1.375% Convertible Senior Notes	$ 500,000	$ -
Discount on 1.375% Convertible Senior Notes	(77,764)	-
1.375% Convertible Senior Notes, net of discount	422,236	-
2.5% Contingent Convertible Senior Notes	168,926	169,145
1.5% Contingent Convertible Senior Notes	181	181
	591,343	169,326
Less current portion	(181)	(169,145)
Total long-term debt	$ 591,162	$ 181

1.375% Convertible Senior Notes Due 2017

On May 16, 2012, the Company issued and sold $500.0 million of its 1.375% Convertible Senior Notes due 2017 (the 1.375% Notes) in a public offering. The 1.375% Notes will mature on June 1, 2017 and pay 1.375% annual cash interest, payable semi-annually in arrears on June 1 and December 1 of each year, beginning on December 1, 2012.

On or after March 1, 2017, until the close of business on the second scheduled trading day immediately preceding the stated maturity date, or prior to then but only under certain circumstances, the 1.375% Notes will be convertible into cash up to the principal amount, with the remaining amount, if any, to be satisfied, at the Company s option, in shares of the Company s Class A common stock, cash or a combination thereof. The 1.375% Notes will be convertible at an initial conversion rate of 21.2427 shares of the Company s Class A common stock per $1,000 principal amount of the 1.375% Notes, subject to adjustment upon certain events, which is equivalent to an initial conversion price of approximately $47.07 per share of the Company s Class A common stock.

The 1.375% Notes are convertible, at the holders option, prior to the close of business on the business day immediately preceding March 1, 2017, into shares of the Company s Class A common stock in the following circumstances:

during any calendar quarter commencing after the calendar quarter ending on September 30, 2012, if the closing price of the Company s Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 130% of the conversion price of the 1.375% Notes in effect on each applicable trading day;

during the five consecutive trading day period immediately following any ten consecutive trading day period in which the trading price of the 1.375% Notes per $1,000 principal amount for each such trading day was less than 98% of the product of the closing sale price of the Company s Class A common stock on such days and the then-current conversion rate of $1,000 principal amount of the 1.375% Notes; or

upon the occurrence of specified corporate transactions.

The 1.375% Notes are senior unsecured obligations of the Company and are not guaranteed by any of the Company s subsidiaries. The 1.375% Notes rank senior in right of payment to the Company s existing and future indebtedness that is expressly subordinated in right of payment to the 1.375% Notes; equal in right of payment to the Company s existing and future unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of the Company s secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness (including trade payables) incurred by the Company s subsidiaries.

The 1.375% Notes do not contain any restrictions on the payment of dividends, the incurrence of additional indebtedness or the repurchase of the Company s securities and do not contain any financial covenants. The 1.375% Notes require an anti-dilution adjustment to the conversion rate upon certain specified corporate dividend or common stock events or transactions, and if such event or transaction would result in at least a one percent (1%) change in the conversion rate. If the one percent (1%) threshold is not met on a particular qualifying event or transaction, the adjustment is carried forward and taken into account when a subsequent qualifying event or transaction is assessed for potential conversion rate adjustment. The Company may not redeem the 1.375% Notes prior to maturity and no sinking fund will be provided for the 1.375% Notes. If the Company undergoes a fundamental change, subject to certain conditions, holders of the 1.375% Notes may require the Company to purchase 1.375% Notes in whole or in part for cash at a fundamental change purchase price equal to 100% of the principal amount of the 1.375% Notes to be purchased, plus accrued and unpaid interest, if any, to, but excluding the fundamental change purchase date. In certain events of default, as defined in the 1.375% Notes indenture, the trustee by notice to the Company, or the holders of at least 25% in principal amount of the then outstanding 1.375% Notes by notice to the Company and trustee, may declare 100% of the principal of, and accrued and unpaid interest, if any, on, all outstanding 1.375% Notes to be due and payable. Upon such a declaration, such principal and accrued and unpaid interest, if any, will be due and payable immediately.

As of June 30, 2012, the 1.375% Notes were not convertible.

The conversion feature embedded within the 1.375% Notes is considered a derivative; however, it has not been bifurcated and accounted for separately because it is considered to be indexed to the Company s Class A common stock and meets the criteria for equity classification. Because the 1.375% Notes are considered to be cash convertible debt, the Company has separately accounted for the liability and equity components of the 1.375% Notes by allocating the $500.0 million in proceeds from the issuance between the liability component and the embedded conversion option, or the equity component. The allocation was conducted by estimating an interest rate at the time of issuance of the 1.375% Notes for similar debt instruments that do not include the embedded conversion feature. A straight-debt interest rate of 5.0% was used to compute the initial fair value of the liability component of $420.5 million. For purposes of the fair value measurement, the Company determined that the valuation of the 1.375% Notes falls under Level 2 of the fair value hierarchy. The excess of the $500.0 million of proceeds from the issuance of the 1.375% Notes over the $420.5 million initial amount allocated to the liability component, or $79.5 million, was allocated to the embedded conversion option, or equity component. This excess was treated as a debt discount and is being amortized through interest expense, using the effective interest method, over the five-year term of the 1.375% Notes, which runs through June 1, 2017.

In connection with the offering of the 1.375% Notes, on May 10, 2012 and May 11, 2012, the Company entered into privately negotiated convertible note hedge transactions (the Convertible Note Hedge Transactions) with affiliates of the underwriters of the 1.375% Notes (the Option Counterparties). The Convertible Note Hedge Transactions cover, collectively, the number of shares of the Company s Class A common stock underlying the 1.375% Notes, subject to anti-dilution adjustments substantially similar to those applicable to the 1.375% Notes. The Company purchased these hedges for $80.0 million, in aggregate, which was recorded as a reduction in additional paid-in capital during the three months ended June 30, 2012. The Company also entered into separate, privately-negotiated warrant transactions with the Option Counterparties on May 10, 2012 and into additional warrant transactions with the Option Counterparties on May 11, 2012 (collectively, the Warrant Transactions and together with the Convertible Note Hedge Transactions, the Convertible Note Hedge and Warrant Transactions), initially covering a number of shares of the Company s Class A common stock underlying the 1.375% Notes, subject to customary anti-dilution adjustments. Subject to certain conditions, the Company may settle the warrants in cash or on a net-share basis. The warrants were issued and sold for proceeds of approximately $35.2 million, which was recorded as an increase in additional paid-in capital during the three months ended June 30, 2012.

The Convertible Note Hedge Transactions are expected to reduce the potential economic dilution with respect to the Company s Class A common stock and/or reduce the Company s exposure to potential cash payments that may be required upon conversion of the 1.375% Notes. The strike price of the Warrant Transactions will initially be approximately $60.26 per share, which represents a premium of approximately 60% over the last reported sale price of $37.66 per share of the Company s Class A common stock on The New York Stock Exchange on May 10, 2012.

The Convertible Note Hedge and Warrant Transactions are considered derivative instruments; however, they have been classified within stockholders equity because both financial instruments are considered to be indexed to the Company s Class A common stock and meet the criteria for equity classification.

The Convertible Note Hedge and Warrant Transactions have been accounted for as separate financial instruments, in each case, entered into by the Company with the Option Counterparties, and are not part of the terms of the 1.375% Notes and will not affect any holder s rights under the 1.375% Notes. Holders of the 1.375% Notes will not have any rights with respect to the Convertible Note Hedge and Warrant Transactions.

The Company incurred $14.2 million of fees and other origination costs related to the issuance of the 1.375% Notes. These fees and other origination costs have been allocated to the liability and equity components of the 1.375% Notes in proportion to their allocated values. Approximately $2.3 million of these fees and other origination costs were recorded as a reduction in additional paid-in capital. The remaining $11.9 million of fees and other origination costs are included in other assets in the Company s condensed consolidated balance sheets and are being amortized through interest expense over the five-year term of the 1.375% Notes, which runs through June 1, 2017.

2.5% Contingent Convertible Senior Notes Due 2032

In June 2002, the Company sold $400.0 million aggregate principal amount of its 2.5% Contingent Convertible Senior Notes Due 2032 (the 2.5% Notes) in private transactions. As discussed below, approximately $230.8 million in principal amount of the 2.5% Notes was exchanged for 1.5% Notes on August 14, 2003. The 2.5% Notes bear interest at a rate of 2.5% per annum, which is payable on June 4 and December 4 of each year, beginning on December 4, 2002. The Company also agreed to pay contingent interest at a rate equal to 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2007, if the average trading price of the 2.5% Notes reaches certain thresholds. Contingent interest of approximately $0.1 million related to the 2.5% Notes was payable at June 30, 2012. No contingent interest related to the 2.5% Notes was payable at December 31, 2011. The 2.5% Notes will mature on June 4, 2032.

The Company may redeem some or all of the 2.5% Notes at any time on or after June 11, 2007, at a redemption price, payable in cash, of 100% of the principal amount of the 2.5% Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the 2.5% Notes may require the Company to repurchase all or a portion of their 2.5% Notes on June 4, 2017, or upon a change in control, as defined in the indenture governing the 2.5% Notes, at 100% of the principal amount of the 2.5% Notes, plus accrued and unpaid interest to the date of the repurchase, payable in cash. Holders of the 2.5% Notes also had this option on June 4, 2012. Under GAAP, if an obligation is due on demand or will be due on demand within one year from the balance sheet date, even though liquidation may not be expected within that period, it should be classified as a current liability. Accordingly, the outstanding balance of 2.5% Notes along with the deferred tax liability associated with accelerated interest deductions on the 2.5% Notes are classified as a current liability during the respective twelve month periods prior to June 4, 2012 and June 4, 2017. As of December 31, 2011, $169.1 million of the 2.5% Notes and $62.5 million of deferred tax liabilities were classified as current liabilities in the Company s condensed consolidated balance sheets. The $62.5 million of deferred tax liabilities were included within current deferred tax assets, net.

On May 3, 2012, the Company filed with the Securities and Exchange Commission (the SEC) a Tender Offer Statement on Schedule TO and a notice (the Company Notice) to the holders of the 2.5% Notes related to the option of the holders to require the Company to repurchase all or a portion of their 2.5% Notes on June 4, 2012. In addition, such Company Notice was made available through The Depository Trust Company and Deutsche Bank Trust Company Americas, the paying agent.

The Company Notice specified the terms, conditions and procedures for surrendering and withdrawing the 2.5% Notes for purchase. Specifically, the Company Notice provided that the opportunity to surrender the 2.5% Notes for purchase would commence on May 3, 2012, and would terminate at 5:00 p.m., Eastern Time, on Friday, June 1, 2012, and also that the holders of the 2.5% Notes could withdraw any 2.5% Notes previously surrendered for purchase at any time prior to 5:00 p.m., Eastern Time, on June 1, 2012.

The Company Notice also stated that holders that did not surrender their 2.5% Notes for purchase would maintain the right to convert their 2.5% Notes into shares of the Company s Class A common stock, as further described below.

Holders of $3,000 in principal amount of the 2.5% Notes requested to have their 2.5% Notes repurchased by the Company.

The 2.5% Notes are convertible, at the holders option, prior to the maturity date into shares of the Company s Class A common stock in the following circumstances:

- during any quarter commencing after June 30, 2002, if the closing price of the Company s Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 110% of the conversion price of the 2.5% Notes, or $31.96. The 2.5% Notes are initially convertible at a conversion price of $29.05 per share, which is equal to a conversion rate of approximately 34.4234 shares per $1,000 principal amount of 2.5% Notes, subject to adjustment;

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if the Company has called the 2.5% Notes for redemption;

during the five trading day period immediately following any nine consecutive day trading period in which the trading price of the 2.5% Notes per $1,000 principal amount for each day of such period was less than 95% of the product of the closing sale price of the Company s Class A common stock on such days multiplied by the number of shares of the Company s Class A common stock issuable upon conversion of $1,000 principal amount of the 2.5% Notes; or

upon the occurrence of specified corporate transactions.

The 2.5% Notes, which are unsecured, do not contain any restrictions on the payment of dividends, the incurrence of additional indebtedness or the repurchase of the Company s securities and do not contain any financial covenants.

The Company incurred $12.6 million of fees and other origination costs related to the issuance of the 2.5% Notes. The Company amortized these costs over the first five-year Put period, which ran through June 4, 2007.

During the quarters ended December 31, 2011, March 31, 2012 and June 30, 2012, the 2.5% Notes met the criteria for the right of conversion into shares of the Company s Class A common stock. This right of conversion of the holders of 2.5% Notes was triggered by the stock closing above $31.96 on 20 of the last 30 trading days and the last trading day of the quarters ended December 31, 2011, March 31, 2012 and June 30, 2012. During the quarter ended June 30, 2012, outstanding principal amounts of $216,000 of 2.5% Notes were converted into shares of the Company s Class A common stock. The holders of the remaining $168.9 million of 2.5% Notes have this conversion right only until September 30, 2012. At the end of each future quarter, the conversion rights will be reassessed in accordance with the bond indenture agreement to determine if the conversion trigger rights have been achieved.

1.5% Contingent Convertible Senior Notes Due 2033

On August 14, 2003, the Company exchanged approximately $230.8 million in principal amount of its 2.5% Notes for approximately $283.9 million in principal amount of its 1.5% Contingent Convertible Senior Notes Due 2033 (the 1.5% Notes). Holders of 2.5% Notes that accepted the Company s exchange offer received $1,230 in principal amount of 1.5% Notes for each $1,000 in principal amount of 2.5% Notes. The terms of the 1.5% Notes are similar to the terms of the 2.5% Notes, but have a different interest rate, conversion rate and maturity date. Holders of 2.5% Notes that chose not to exchange continue to be subject to the terms of the 2.5% Notes.

The 1.5% Notes bear interest at a rate of 1.5% per annum, which is payable on June 4 and December 4 of each year, beginning December 4, 2003. The Company will also pay contingent interest at a rate of 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2008, if the average trading price of the 1.5% Notes reaches certain thresholds. No contingent interest related to the 1.5% Notes was payable at June 30, 2012 or December 31, 2011. The 1.5% Notes will mature on June 4, 2033.

As a result of the exchange, the outstanding principal amounts of the 2.5% Notes and the 1.5% Notes were $169.2 million and $283.9 million, respectively. The Company incurred approximately $5.1 million of fees and other origination costs related to the issuance of the 1.5% Notes. The Company amortized these costs over the first five-year Put period, which ran through June 4, 2008.

Holders of the 1.5% Notes were able to require the Company to repurchase all or a portion of their 1.5% Notes on June 4, 2008, at 100% of the principal amount of the 1.5% Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash. Holders of approximately $283.7 million of 1.5% Notes elected to require the Company to repurchase their 1.5% Notes on June 4, 2008. The Company paid $283.7 million, plus accrued and unpaid interest of approximately $2.2 million, to the holders of 1.5% Notes that elected to require the Company to repurchase their 1.5% Notes. The Company was also required to

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pay an accumulated deferred tax liability of approximately $34.9 million related to the repurchased 1.5% Notes. This $34.9 million deferred tax liability was paid during the second half of 2008. Following the repurchase of these 1.5% Notes, $181,000 of principal amount of 1.5% Notes remained outstanding as of June 30, 2012 and December 31, 2011.

Remaining holders of the 1.5% Notes may require the Company to repurchase all or a portion of their 1.5% Notes on June 4, 2013 and June 4, 2018, or upon a change in control, as defined in the indenture governing the 1.5% Notes, at 100% of the principal amount of the 1.5% Notes, plus accrued and unpaid interest to the date of the repurchase, payable in cash. Under GAAP, if an obligation is due on demand or will be due on demand within one year from the balance sheet date, even though liquidation may not be expected within that period, it should be classified as a current liability. Accordingly, the outstanding balance of 1.5% Notes along with the deferred tax liability associated with accelerated interest deductions on the 1.5% Notes will be classified as a current liability during the respective twelve month periods prior to June 4, 2013 and June 4, 2018. As of June 30, 2012, $181,000 of the 1.5% Notes and $55,000 of deferred tax liabilities were classified as current liabilities in the Company s condensed consolidated balance sheets. The $55,000 of deferred tax liabilities were included within current deferred tax assets, net.

The remaining 1.5% Notes are convertible, at the holders option, prior to the maturity date into shares of the Company s Class A common stock in the following circumstances:

- during any quarter commencing after September 30, 2003, if the closing price of the Company s Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 120% of the conversion price of the 1.5% Notes, or $46.51. The 1.5% Notes are initially convertible at a conversion price of $38.76 per share, which is equal to a conversion rate of approximately 25.7998 shares per $1,000 principal amount of 1.5% Notes, subject to adjustment;

- if the Company has called the 1.5% Notes for redemption;

- during the five trading day period immediately following any nine consecutive day trading period in which the trading price of the 1.5% Notes per $1,000 principal amount for each day of such period was less than 95% of the product of the closing sale price of the Company s Class A common stock on such days multiplied by the number of shares of the Company s Class A common stock issuable upon conversion of $1,000 principal amount of the 1.5% Notes; or

- upon the occurrence of specified corporate transactions.

The remaining 1.5% Notes, which are unsecured, do not contain any restrictions on the incurrence of additional indebtedness or the repurchase of the Company s securities and do not contain any financial covenants. The 1.5% Notes require an adjustment to the conversion price if the cumulative aggregate of all current and prior dividend increases, through June 11, 2008, above $0.025 per share would result in at least a one percent (1%) increase in the conversion price. This threshold was not reached and no adjustment to the conversion price has been made.

During the quarter ended June 30, 2012, the 1.5% Notes did not meet the criteria for the right of conversion.

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Interest expense

Interest expense recognized related to the Company s long-term debt during the three and six months ended June 30, 2012 and 2011 was as follows (in thousands):

	Three Months Ended		Six Months Ended June 30,	
	June 30, 2012	June 30, 2011	2012	June 30, 2011
1.375% Notes:				
Coupon rate interest	$ 850	$ -	$ 850	$ -
Amortization of discount	1,750	-	1,750	-
Amortization of issuance costs	296	-	296	-
Total 1.375% Notes	2,896	-	2,896	-
2.5% Notes:				
Coupon rate interest	1,057	1,057	2,114	2,114
Contingent interest	70	70	70	70
Total 2.5% Notes	1,127	1,127	2,184	2,184
1.5% Notes:				
Coupon rate interest	1	1	2	2
Total 1.5% Notes	1	1	2	2
Total interest expense related to long-term debt	$ 4,024	$ 1,128	$ 5,082	$ 2,186

Fair value of long-term debt

The fair value of the Company s long-term debt, based on market quotations, was approximately $707.6 million and $202.5 million at June 30, 2012 and December 31, 2011, respectively. The fair value of the long-term debt held as of June 30, 2012 and December 31, 2011 were valued using Level 2 pricing inputs based on quoted prices for similar instruments in markets that are not active, and through model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

13. INCOME TAXES

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

On November 1, 2011, the Company closed its sale of all issued and outstanding shares of common stock of LipoSonix to Solta. The transaction resulted in a $30.5 million capital loss for income tax purposes, of which $26.2 million can be carried back and used to offset capital gains generated in prior tax years. Accordingly, an income tax benefit of $9.4 million was recognized and is included in the gain from discontinued operations for the year ended December 31, 2011. A deferred tax asset was recorded on the portion of the capital loss ($4.3 million) that could not be carried back to prior years. As a capital loss can only be utilized to offset capital gains, the Company recorded at December 31, 2011 a valuation allowance of $1.5 million against the deferred tax asset in order to reduce the carrying value of the deferred tax asset to $0, which was the amount that management believed was more likely than not to be realized. During the six months ended June 30, 2012, the Company recognized a $6.0 million capital gain (see Note 8), and accordingly, the reversal of this $1.5 million valuation allowance has been reflected in the Company s estimate of its annual effective tax rate for 2012.

The sales price used to calculate the above capital loss consisted of $15.5 million of cash received at closing, $20.0 million of cash received on November 18, 2011 and $29.3 million of value from future additional contingent cash and milestone payments. A deferred tax asset was recorded on the $29.3 million as it was not recognized as additional selling price for financial reporting purposes. The Company has recorded a valuation allowance of $10.5 million against this deferred tax asset in order to reduce the carrying value of this deferred tax asset to $0, which is the amount that management believes is more likely than not to be realized.

At June 30, 2012, the Company has an unrealized tax loss of $21.0 million related to the Company s option to acquire Revance or license Revance s topical product that is under development. The Company will not be able to determine the character of the loss until the Company exercises or fails to exercise its option. A realized loss characterized as a capital loss can only be utilized to offset capital gains. At June 30, 2012, the Company has recorded a valuation allowance of $7.6 million against the deferred tax asset associated with this unrealized tax loss in order to reduce the carrying value of the deferred tax asset to $0, which is the amount that management believes is more likely than not to be realized.

At June 30, 2012, the Company has an unrealized tax loss of $21.9 million related to the Company s option to acquire a privately-held U.S. biotechnology company. If the Company fails to exercise its option, a capital loss will be recognized. A loss characterized as a capital loss can only be used to offset capital gains. At June 30, 2012, the Company has recorded a valuation allowance of $7.9 million against the deferred tax asset associated with this unrealized tax loss in order to reduce the carrying value of the deferred tax asset to $0, which is the amount that management believes is more likely than not to be realized.

During the three months ended June 30, 2012 and June 30, 2011, the Company made net tax payments of $31.1 million and $32.0 million, respectively. During the six months ended June 30, 2012 and June 30, 2011, the Company made net tax payments of $42.4 million and $38.0 million, respectively.

The Company operates in multiple tax jurisdictions and is periodically subject to audit in these jurisdictions. These audits can involve complex issues that may require an extended period of time to resolve and may cover multiple years. The Company and its domestic subsidiaries file a consolidated U.S. federal income tax return. Such returns have either been audited or settled through statute expiration through 2007. The state of California is currently conducting an examination of the Company s tax returns for the periods ending December 31, 2008 and December 31, 2009.

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

At June 30, 2012 and December 31, 2011, the Company had unrecognized tax benefits of $10.1 million and $8.6 million, respectively. The amount of unrecognized tax benefits which, if ultimately recognized, could favorably affect the Company s effective tax rate in a future period is $6.7 million and $5.6 million as of June 30, 2012 and December 31, 2011, respectively. The Company estimates that it is reasonably possible that the amount of unrecognized tax benefits will decrease by $0.3 million in the next twelve months due to audit settlements.

The Company recognizes accrued interest and penalties, if applicable, related to unrecognized tax benefits in income tax expense. The Company had approximately $0.4 million and $0.3 million for the payment of interest and penalties accrued (net of tax benefit) at June 30, 2012 and December 31, 2011, respectively.

14. DIVIDENDS DECLARED ON COMMON STOCK

On June 14, 2012, the Company announced that its Board of Directors had declared a cash dividend of $0.10 per issued and outstanding share of the Company s Class A common stock, which was paid on July 31, 2012, to stockholders of record at the close of business on July 2, 2012. The $6.0 million dividend was recorded as a reduction of accumulated earnings and is included in other current liabilities in the accompanying condensed consolidated balance sheets as of June 30, 2012. The Company has not adopted a dividend policy.

15. STOCK REPURCHASE

On August 8, 2011, the Company announced that its Board of Directors approved a Stock Repurchase Plan to purchase up to $200 million in aggregate value of shares of Medicis Class A common stock (common stock). The plan was set to expire on August 7, 2012; however, on August 7, 2012, the Company s Board of Directors approved a six-month extension of the plan to February 7, 2013. The plan may also terminate at the time at which the purchase limit is reached, and may be suspended or terminated at any time at the Company s discretion without prior notice.

Any repurchases will be made in compliance with the SEC s Rule 10b-18 if applicable, and may be made in the open market or in privately negotiated transactions, including the entry into derivatives transactions.

The number of shares to be repurchased and the timing of repurchases will depend on a variety of factors, including, but not limited to, stock price, economic and market conditions and corporate and regulatory requirements. It is intended that any repurchases will be funded by existing general corporate funds. The plan does not obligate the Company to repurchase any common stock.

As part of its stock repurchase program, the Company may from time to time enter into structured share repurchase agreements with financial institutions. These agreements generally require the Company to make one or more cash payments in exchange for the right to receive shares of its common stock and/or cash at the expiration of the agreement and/or at various times during the term of the agreement, generally based on the market price of the Company s common stock during the relevant valuation period or periods, but the Company may enter into structured share repurchase agreements with different features.

No shares were repurchased during the six months ended June 30, 2012. Total shares repurchased from the inception of the plan through June 30, 2012 in the open market and through structured share repurchase arrangements was 4,438,233 shares at a weighted average cost of $33.82 per share.

As of June 30, 2012, the remaining authorized amount under the plan is approximately $49.9 million.

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16. NET INCOME PER COMMON SHARE

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

	Three Months Ended					
	June 30, 2012			June 30, 2011		
	Continuing Operations	Discontinued Operations	Net Income	Continuing Operations	Discontinued Operations	Net Income
BASIC						
Net income (loss)	$ 14,926	$ -	$ 14,926	$ 34,512	$ (5,729)	$ 28,783
Less: income (loss) allocated to participating securities	453	-	453	1,113	-	916
Net income (loss) available to common stockholders	14,473	-	14,473	33,399	(5,729)	27,867
Weighted average number of common shares outstanding	57,560	-	57,560	60,308	60,308	60,308
Basic net income (loss) per common share	$ 0.25	$ -	$ 0.25	$ 0.55	$ (0.09)	$ 0.46
DILUTED						
Net income (loss)	$ 14,926	$ -	$ 14,926	$ 34,512	$ (5,729)	$ 28,783
Less: income (loss) allocated to participating securities	453	-	453	1,113	-	916
Net income (loss) available to common stockholders	14,473	-	14,473	33,399	(5,729)	27,867
Less:						
Undistributed earnings allocated to unvested stockholders	(307)	-	(307)	(987)	-	(796)
Add:						
Undistributed earnings re-allocated to unvested stockholders	304	-	304	971	-	783
Add:						
Tax-effected interest expense related to 2.5% Notes	711	-	711	711	-	711
Net income (loss) assuming dilution	$ 15,181	$ -	$ 15,181	$ 34,094	$ (5,729)	$ 28,565
Weighted average number of common shares outstanding	57,560	-	57,560	60,308	60,308	60,308
Effect of dilutive securities:						
2.5% Notes	5,822	-	5,822	5,823	-	5,823
1.5% Notes	4	-	4	4	-	4
Stock options	594	-	594	1,005	-	1,005
Weighted average number of common shares assuming dilution	63,980	-	63,980	67,140	60,308	67,140
Diluted net income (loss) per common share	$ 0.24	$ -	$ 0.24	$ 0.51	$ (0.09)	$ 0.43