PHARMACIA CORP /DE/
Form 10-Q
November 13, 2001

Table of Contents

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

Form 10-Q

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

For the Quarterly Period Ended September 30, 2001

or

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

For the Transition Period From to

Commission File Number 1-2516

PHARMACIA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**43-0420020**
(State of incorporation)	*(I.R.S. Employer Identification No.)*
Pharmacia Corporation, 100 Route 206 North, Peapack, NJ	**07977**
(Address of principal executive offices)	*(Zip Code)*

908/901-8000

Registrant s telephone number

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 twelve months, and (2) has been subject to such filing requirements for the past 90 days. þ Yes o No

The number of shares of Common Stock, $2 Par Value, outstanding as of October 31, 2001 was 1,289,413,209

TABLE OF CONTENTS

Table of Contents

QUARTERLY REPORT ON FORM 10-Q

PHARMACIA CORPORATION
QUARTER ENDED SEPTEMBER 30, 2001
INDEX OF INFORMATION INCLUDED IN REPORT

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

PHARMACIA CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2001	2000	2001	2000
	(Dollars in millions, except per-share data) (Unaudited)			
Net sales	$4,466	$4,289	$14,406	$13,648
Cost of products sold	1,255	1,295	4,255	4,212
Research and development	653	662	2,064	2,073
Selling, general and administrative	1,734	1,602	5,237	4,958
Amortization and adjustment of goodwill	54	57	170	259
Merger and restructuring	109	226	460	798
Interest expense	69	102	239	303
Interest income	(13)	(34)	(82)	(88)
All other, net	63	18	76	(13)
Earnings before income taxes and minority interest	542	361	1,987	1,146
Provision for income taxes	121	83	494	361
Minority interest in agricultural subsidiaries, net of tax	(7)		59	
Earnings from continuing operations	428	278	1,434	785
Loss on sale of discontinued operations, net of tax		(26)	(8)	(27)
Earnings before extraordinary items and cumulative effect of accounting change	428	252	1,426	758
Extraordinary items, net of tax			(12)	
Cumulative effect of accounting change, net of tax			1	(198)
Net earnings	$ 428	$ 252	$ 1,415	$ 560
Earnings per common share:				
Basic				
Earnings from continuing operations	$ .32	$ .22	$ 1.09	$ .61
Net earnings	.32	.20	1.08	.44
Diluted				
Earnings from continuing operations	$ .32	$ .21	$ 1.07	$ .60
Net earnings	.32	.19	1.06	.43

See accompanying notes.

Table of Contents

PHARMACIA CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Nine Months Ended September 30,	
	2001	**2000**
	(Dollars in millions) (Unaudited)	
Net cash provided by continuing operations	$ 1,168	$ 643
Net cash (required) by discontinued operations		(25)
Net cash provided by operations	1,168	618
Cash flows (required) provided by investment activities:		
Proceeds from sales of investments	152	113
Purchases of other acquisitions and investments	(186)	(190)
Purchases of property, plant and equipment	(900)	(960)
Proceeds from sales of interests in subsidiaries	21	75
Purchases of subsidiaries	(65)	(4)
Proceeds from sale of discontinued operations, net		1,669
Other	(24)	8
Net cash (required) provided by investment activities	(1,002)	711
Cash flows provided (required) by financing activities:		
Proceeds from issuance of debt	53	12
Repayment of debt	(831)	(587)
Payments of ESOP debt	(85)	(31)
Net increase (decrease) in short-term borrowings	1,157	(1,139)
Dividend payments	(497)	(513)
Issuance of stock	158	967
Purchases of treasury stock	(315)	
Net cash (required) by financing activities	(360)	(1,291)
Effect of exchange rate changes on cash	(93)	(130)
Net change in cash and cash equivalents	(287)	(92)
Cash and cash equivalents, beginning of year	2,166	1,600
Cash and cash equivalents, end of period	$ 1,879	$ 1,508

See accompanying notes.

Table of Contents

PHARMACIA CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2001	December 31, 2000
	(Dollars in millions) (Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,879	$ 2,166
Trade accounts receivable, less allowance of $303 (2000: $292)	5,574	5,025
Inventories	3,018	2,772
Other current assets	1,965	1,604
Total current assets	12,436	11,567
Long-term investments	194	444
Properties, net	7,258	7,171
Goodwill and other intangible assets, net	4,964	5,259
Other noncurrent assets	1,948	2,215
Total assets	$26,800	$26,656
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Short-term debt, including current maturities of long-term debt	$ 1,990	$ 833
Accounts payable	1,173	1,361
Other current liabilities	3,946	3,967
Total current liabilities	7,109	6,161
Long-term debt and guarantee of ESOP debt	3,723	4,586
Other noncurrent liabilities	2,666	2,904
Minority interest in agricultural subsidiaries	1,077	1,084
Total liabilities	14,575	14,735
Shareholders equity:		
Preferred stock, one cent par value; at stated value; authorized 10 million shares; issued 6,430 shares (2000: 6,518 shares)	259	263
Common stock, two dollar par value; authorized 3 billion shares; issued 1.468 billion shares	2,937	2,937
Capital in excess of par value	2,769	2,694
Retained earnings	11,668	10,781
ESOP-related accounts	(297)	(307)
Treasury stock	(2,262)	(2,003)
Accumulated other comprehensive loss	(2,849)	(2,444)
Total shareholders equity	12,225	11,921
Total liabilities and shareholders equity	$26,800	$26,656

See accompanying notes.

4

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED

(Dollars in millions, except per-share data unless otherwise indicated)

Trademarks are indicated in all upper case letters. In the notes that follow, per-share amounts are presented on a diluted, after-tax basis.

The term the company is used to refer to Pharmacia Corporation or to Pharmacia Corporation and its subsidiaries, as appropriate to the context. The term former Monsanto is used to refer to pre-merger operations of the former Monsanto Company and Monsanto refers to the agricultural subsidiary.

A INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial information presented herein is unaudited, other than the condensed balance sheet at December 31, 2000, which is derived from audited financial statements. The interim financial statements and notes thereto do not include all disclosures required by generally accepted accounting principles and should be read in conjunction with the financial statements and notes thereto included in Pharmacia Corporation s annual report filed on Form 10-K for the year ended December 31, 2000.

In the opinion of management, the interim financial statements reflect all adjustments of a normal recurring nature necessary for a fair statement of the results for interim periods. The current period s results of operations are not necessarily indicative of results that ultimately may be achieved for the year.

B NEW ACCOUNTING STANDARDS

Business Combinations

On July 1, 2001, Statement of Financial Accounting Standards (SFAS) No. 141 Business Combinations became effective. The new rules require that the purchase method of accounting be used for all business combinations after June 30, 2001. The use of the pooling of interests method is now prohibited. There was no impact on the company s financial statements due to the adoption of these rules.

Derivative Instruments and Hedging

On January 1, 2001, the company adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and its amendments. This statement requires companies to record derivatives on the balance sheet as assets and liabilities measured at fair value. The accounting treatment of gains and losses resulting from changes in the value of derivatives depends on the use of the derivative and whether it qualifies for hedge accounting. Gains and losses on non-hedging instruments attributable to changes in the fair value are recorded in earnings. If elected and qualified, special hedge accounting is available whereby gains and losses on derivatives and certain other instruments can be offset or deferred.

In accordance with the transition provisions of SFAS 133, the company recorded a net-of-tax cumulative effect adjustment in earnings as of January 1, 2001 for approximately a $1 gain. This amount was comprised of the excluded component of instruments previously designated in cash flow hedges and other changes in recorded basis to bring derivatives to fair value, both of which were less than $1 on an individual basis. Also included in the $1 gain were offsetting adjustments to the carrying value of a hedged item and the hedging derivative for a fair value hedge each in the amount of $19. A similar cumulative effect adjustment in the amount of $3 (net of tax) has been made on the balance sheet to other comprehensive income. This amount reflects the deferred amount of derivative instruments previously designated in cash flow hedges.

Upon adopting SFAS 133, the company elected to reclassify $52 of held-to-maturity securities as available-for-sale securities. The unrealized gain associated with the reclassification was not material and is recorded in other comprehensive income. Under the provisions of SFAS 133, such a reclassification does not call into question the company s intent to hold current or future debt securities until their maturity.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED (Continued)

Revenue Recognition

In connection with the fourth quarter 2000 adoption of the interpretations of Securities and Exchange Commission (SEC) Staff Accounting Bulletin 101, Revenue Recognition in Financial Statements (SAB 101), the company recorded a cumulative effect of a change in accounting principle, effective January 1, 2000, and restated the quarterly results of 2000 as if SAB 101 had been applied for each quarter. For a further discussion of this accounting change, see the company s Form 10-K for the year ended December 31, 2000.

C ACQUISITION

During March 2001, the company completed the acquisition of Sensus Drug Development Corporation by purchasing the remaining 80.1 percent of its stock. The assets purchased were valued at $117, which includes $67 allocated to in-process research and development. Cash paid in connection with this purchase was $65 and included certain direct closing costs and is net of contractual holdback amounts.

D EXTRAORDINARY ITEMS

Through a private transaction completed in July 2001, the company retired debt related to the adjustable conversion-rate equity securities (ACES) in the principal amount of $700. Premium on the debt and other direct costs of $8 (net of taxes of $5) were accrued as an extraordinary item.

On June 28, 2001, the company retired certain debt obligations relating to one of the employee stock ownership plans. The principal amount of the debt was $65. Certain costs related to the transaction, including a premium to retire the debt and other direct costs, were $4 (net of taxes of $2) and have been classified as an extraordinary item on the company s consolidated statements of earnings.

E COMPREHENSIVE INCOME

Comprehensive income for the three months ended September 30, 2001 and 2000 was $383 and $168, respectively. Comprehensive income for the nine months ended September 30, 2001 and 2000 was $1,010 and $591, respectively.

F MERGER AND RESTRUCTURING CHARGES

The company recorded an additional $111 of merger and restructuring charges during the third quarter of 2001 in connection with the merger and integration of the former Monsanto and Pharmacia & Upjohn companies into Pharmacia Corporation. These charges are part of the comprehensive integration plan approved by the board of directors during 2000. Of the total charges in the quarter, $109, comprised of $82 of merger costs and $27 of restructuring expenses was recorded on the merger and restructuring line of the earnings statement and an additional $2 was recorded in cost of products sold.

For the nine months ended September 30, 2001, the company recorded a total of $473 of merger and restructuring costs. Of this total, $460, comprised of $276 of merger costs and $184 of restructuring expenses was recorded on the merger and restructuring line of the earnings statement and an additional $13 was recorded in cost of products sold.

The $276 of 2001 merger charges relates primarily to costs incurred to integrate the former companies into a single organization such as consultant and relocation costs. This effort also includes the company s initiative to exit its Sweden-based metabolic diseases research activities, biopharmaceutical development unit and the company s plasma business. As a result of this effort, the company entered into a definitive agreement on June 7, 2001 related to the partial divesture of these operations, establishing Biovitrum AB (Biovitrum). As of September 2001, approximately $55 in merger costs were recorded relating to this transaction, including the write-down of the net assets to market value and certain transaction-related expenses. At September 30, 2001, Pharmacia owned approximately 35 percent of Biovitrum with the remaining shares owned by outside

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED (Continued)

investors. In early November 2001, Pharmacia further reduced its holdings in Biovitrum through additional sales of shares to outside investors. These subsequent dispositions reduce the company s equity in Biovitrum to 19 percent.

The $29 of aggregate restructuring costs for the quarter comprises $17 related to prescription pharmaceuticals, $1 associated with corporate and administrative functions and $11 in connection with the agricultural subsidiary. On a year-to-date basis, the company has recorded $197 of aggregate restructuring charges as follows: $105 associated with prescription pharmaceuticals, $16 associated with corporate and administrative functions, $2 in connection with other pharmaceutical operations and $74 related to the agricultural subsidiary.

The $17 relating to prescription pharmaceuticals consists of $9 in connection with the termination of approximately 113 employees, $6 associated with other exit costs and $2 relating to the write-down of assets such as duplicate computer systems and leasehold improvements. For the nine months ended September 30, 2001, the $105 of total restructuring charges associated with prescription pharmaceuticals comprises $72 in connection with the separation of approximately 473 employees, $19 resulting from asset write downs and $14 associated with other exit costs.

The $1 associated with the corporate and administrative functions represents the separation of approximately 10 employees. The 2001 year-to-date total of $16 for corporate and administrative functions includes $11 relating to the separation of approximately 100 employees and $5 of asset write-offs. Although there are no charges associated with the other pharmaceutical operations during the third quarter 2001, the year-to-date restructuring balance includes $2 associated with the separation of approximately 10 employees.

The $11 of restructuring charges associated with the agricultural subsidiary is composed of $9 on the merger and restructuring line and $2 on the cost of products sold line of the consolidated statement of earnings. The $2 in cost of products sold relates to the write-off of inventories in connection with Monsanto s restructuring plan. The $9 in merger and restructuring comprises of $1 relating to workforce reduction costs associated with the involuntary separation of approximately 30 employees, $4 relating to other exit costs including contract termination costs resulting from the exit of certain research programs and non-core activities, and $4 relating to the write-off of assets. For the 2001 year-to-date total of $74 ($13 in cost of products sold and $61 in merger and restructuring), Monsanto recorded $21 in connection with the involuntary separation of approximately 260 employees, $22 relating to facility closures and other exit costs, $18 in connection with the write-down of assets and $13 in cost of products sold in connection with the write-off of inventories.

During the third quarter 2000, the company recorded aggregate merger and restructuring charges of $226. Of that amount, $52 of merger costs was recorded on the merger and restructuring line for the quarter with total merger-related costs of $525 for the first nine months of 2000. These merger-related costs are comprised, in part, of transaction costs including investment bankers, attorneys, registration and regulatory fees and other professional services. In addition, these costs included various employee incentive and change-of-control costs directly associated with the merger. The latter includes a non-cash charge of $232 during the first quarter that was related to certain employee stock options that were re-priced in conjunction with the merger pursuant to change of control provisions. Pursuant to the terms of these premium options, at consummation of the merger, the original above-market exercise price was reduced to equal the fair market value on the date of grant.

The $174 of restructuring charges during the third quarter of 2000 was recorded within the merger and restructuring line of the earnings statement. This is comprised of $138 associated with the separation of 630 employees in the pharmaceutical and corporate functions and 215 employees in the agricultural subsidiary and $26 relating to assets to be disposed of and $10 associated with contract terminations and other exit costs.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED (Continued)

Third quarter 2000 restructuring charges were comprised of $34 relating to corporate functions, $114 for pharmaceutical operations and $26 for agricultural products. The corporate component relates to the separation of 65 employees. Pharmaceutical operations restructuring activities include the separation of approximately 565 employees, assets disposed of $23 and contract terminations and other exit costs of $8. These charges are the result of integrating the former Pharmacia & Upjohn and Monsanto companies into a single organization and the resulting elimination of duplicate positions and facilities. On a year-to-date basis, pharmaceutical and corporate functions have incurred total restructuring charges of $207, all of which was recorded on the merger and restructuring line of the earnings statement. These charges encompass the separation costs for approximately 680 employees, assets to be disposed of $23 and other exit costs of $8.

The third quarter 2000 restructuring charge of the agricultural subsidiary for $26 includes the separation cost of approximately 215 employees, asset impairments of $3 and contract termination and other exit costs of $2. Year-to-date 2000 restructuring charges for the agricultural subsidiary were $183. These charges are comprised of separation costs for 590 employees, asset impairments of $132 and other exit costs of $3 and were recorded on the earnings statement as cost of products sold of $32, amortization and adjustment of goodwill of $84 and $67 to the merger and restructuring line.

A rollforward from year-end 2000 of restructuring charges and spending associated with the current restructuring plans relating to the integration of the former Monsanto and Pharmacia & Upjohn companies and the restructuring of the agricultural products and other pharmaceutical operations is included in the table below. As of September 30, 2001, the company has paid a total of $385 relating to the separation of approximately 2,869 employees associated with these restructuring plans.

	Workforce Reductions	Other Exit Costs	Total
December 31, 2000	$ 192	$ 15	$ 207
Year-to-date charges	106	36	142
Year-to-date spending	(238)	(35)	(273)
September 30, 2001	$ 60	$ 16	$ 76

G EARNINGS PER SHARE

Basic earnings per share is computed by dividing the earnings measure by the weighted average number of shares of common stock outstanding. Diluted earnings per share is computed assuming the exercise of stock options, conversion of preferred stock, and the issuance of stock as incentive compensation to certain employees. Also in the diluted computation, earnings from continuing operations and net earnings are reduced by an incremental contribution to the Employee Stock Ownership Plan (ESOP). This contribution is the after-tax difference between the income that the ESOP would have received in preferred stock dividends and the dividend on the common shares assumed to have been outstanding.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED (Continued)

The following table reconciles the numerators and denominators of the basic and diluted earnings per share computations:

	For the Three Months Ended September 30,			
	2001		2000	
	Basic	Diluted	Basic	Diluted
EPS numerator:				
Earnings from continuing operations	$ 428	$ 428	$ 278	$ 278
Less: Preferred stock dividends, net of tax	(4)		(4)	
Less: ESOP contribution, net of tax		(2)		(2)
Earnings from continuing operations available to common shareholders	$ 424	$ 426	$ 274	$ 276
EPS denominator:				
Average common shares outstanding	1,299	1,299	1,280	1,280
Effect of dilutive securities:				
Stock options and stock warrants		10		25
Convertible instruments and incentive compensation		12		