MEDICIS PHARMACEUTICAL CORP
Form 10-Q
November 10, 2008

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

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number 0-18443

MEDICIS PHARMACEUTICAL CORPORATION

(Exact name of Registrant as specified in its charter)

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

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 þ NO o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

Class	Shares Outstanding at November 3, 2008
Class A Common Stock $.014 Par Value	56,717,496

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Part I. Financial Information
Item 1. Financial Statements

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

	September 30, 2008 (unaudited)	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 59,021	$ 108,046
Short-term investments	248,124	686,634
Accounts receivable, net	48,011	22,205
Inventories, net	25,433	29,973
Deferred tax assets, net	44,992	9,190
Other current assets	21,050	18,049
Total current assets	446,631	874,097
Property and equipment, net	26,214	13,850
Intangible assets:		
Intangible assets related to product line acquisitions and business combinations	265,573	258,873
Other intangible assets	10,141	6,695
	275,714	265,568
Less: accumulated amortization	108,686	92,482
Net intangible assets	167,028	173,086
Goodwill	156,774	63,107
Deferred tax assets, net	74,513	59,577
Long-term investments	93,422	17,072
Other assets	6,532	12,622
	$ 971,114	$ 1,213,411

See accompanying notes to condensed consolidated financial statements.

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

	September 30, 2008 (unaudited)	December 31, 2007
Liabilities		
Current liabilities:		
Accounts payable	$ 48,236	$ 34,891
Current portion of contingent convertible senior notes	181	283,910
Reserve for sales returns	59,295	68,787
Income taxes payable		7,731
Other current liabilities	71,674	55,807
Total current liabilities	179,386	451,126
Long-term liabilities:		
Contingent convertible senior notes	169,145	169,145
Deferred revenue	4,792	6,667
Other liabilities	10,896	3,172
Stockholders Equity		
Preferred stock, $0.01 par value; shares authorized: 5,000,000; no shares issued		
Class A common stock, $0.014 par value; shares authorized: 150,000,000; issued and outstanding: 69,395,894 and 69,005,019 at September 30, 2008 and December 31, 2007, respectively	969	965
Class B common stock, $0.014 par value; shares authorized: 1,000,000; no shares issued		
Additional paid-in capital	658,645	641,907
Accumulated other comprehensive (loss) income	(2,543)	2,221
Accumulated earnings	293,190	281,218
Less: Treasury stock, 12,678,398 and 12,656,503 shares at cost at September 30, 2008 and December 31, 2007, respectively	(343,366)	(343,010)
Total stockholders equity	606,895	583,301
	$ 971,114	$ 1,213,411

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007 (Restated)	2008	2007 (Restated)
Net product revenues	$ 110,574	$ 107,093	$ 368,668	$ 313,659
Net contract revenues	4,851	3,890	13,111	9,595
Net revenues	115,425	110,983	381,779	323,254
Cost of product revenues (1)	10,848	18,583	31,185	45,411
Gross profit	104,577	92,400	350,594	277,843
Operating expenses:				
Selling, general and administrative (2)	71,575	58,877	215,509	178,712
Impairment of long-lived assets				4,067
Research and development (3)	7,143	7,354	49,333	22,508
In-process research and development	30,500		30,500	
Depreciation and amortization	7,078	6,461	20,579	17,793
Operating (loss) income	(11,719)	19,708	34,673	54,763
Other expense	(2,593)		(5,465)	
Interest and investment income	3,436	9,842	20,086	28,100
Interest expense	(1,059)	(2,396)	(5,614)	(7,622)
(Loss) income before income tax expense	(11,935)	27,154	43,680	75,241
Income tax expense	2,722	10,161	24,802	28,027
Net (loss) income	$ (14,657)	$ 16,993	$ 18,878	$ 47,214
Basic net (loss) income per share	$ (0.26)	$ 0.30	$ 0.33	$ 0.84
Diluted net (loss) income per share	$ (0.26)	$ 0.26	$ 0.33	$ 0.73

Cash dividend declared per common share	$ 0.04	$ 0.03	$ 0.12	$ 0.09
Basic common shares outstanding	56,698	56,120	56,517	55,896
Diluted common shares outstanding	56,698	71,155	57,358	71,353
(1) amounts exclude amortization of intangible assets related to acquired products	$ 5,454	$ 5,671	$ 16,026	$ 15,634
(2) amounts include share-based compensation expense	$ 4,019	$ 4,744	$ 12,949	$ 15,646
(3) amounts include share-based compensation expense	$ 111	$ (215)	$ 223	$ 40

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended	
	September 30, 2008	September 30, 2007 (Restated)
Operating Activities:		
Net income	$ 18,878	$ 47,214
Adjustments to reconcile net income to net cash provided by operating activities:		
In-process research and development	30,500	
Depreciation and amortization	20,579	17,793
Amortization of deferred financing fees	666	1,249
Impairment of long-lived assets		4,067
Loss on disposal of property and equipment	36	19
Charge reducing value of investment in Revance	5,465	
Gain on sale of available-for-sale investments	(1,021)	(49)
Share-based compensation expense	13,172	15,686
Deferred income tax (benefit) expense	(31,994)	9,328
Tax (expense) benefit from exercise of stock options and vesting of restricted stock awards	(1,276)	2,664
Excess tax benefits from share-based payment arrangements	(169)	(1,365)
Increase (decrease) in provision for sales discounts and chargebacks	1,314	(1,078)
Amortization of (discount)/premium on investments	(438)	(2,405)
Changes in operating assets and liabilities:		
Accounts receivable	(26,615)	35,952
Inventories	5,486	(1,526)
Other current assets	(2,550)	262
Accounts payable	12,911	3,030
Reserve for sales returns	(9,492)	(19,652)
Income taxes payable	(7,731)	(3,423)
Other current liabilities	13,342	9,269
Other liabilities	(338)	10,503
Net cash provided by operating activities	40,725	127,538
Investing Activities:		
Purchase of property and equipment	(9,395)	(7,195)
LipoSonix acquisition, net of cash acquired	(149,805)	
Payment of direct merger costs	(3,615)	
Payments for purchase of product rights	(746)	(30,090)
Increase in other assets	(35)	
Purchase of available-for-sale investments	(329,021)	(570,463)
Sale of available-for-sale investments	390,921	173,014
Maturity of available-for-sale investments	297,038	173,396

Net cash provided by (used in) investing activities	195,342	(261,338)
Financing Activities:		
Payment of dividends	(6,295)	(5,063)
Payment of contingent convertible senior notes	(283,729)	(5)
Excess tax benefits from share-based payment arrangements	169	1,365
Proceeds from the exercise of stock options	4,846	17,052
Net cash (used in) provided by financing activities	(285,009)	13,349
Effect of exchange rate on cash and cash equivalents	(83)	713
Net decrease in cash and cash equivalents	(49,025)	(119,738)
Cash and cash equivalents at beginning of period	108,046	203,319
Cash and cash equivalents at end of period	$ 59,021	$ 83,581

See accompanying notes to condensed consolidated financial statements.

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MEDICIS PHARMACEUTICAL CORPORATION
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited)

1. NATURE OF BUSINESS

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

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

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

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

2. RESTATEMENT OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On November 10, 2008, the Company restated its financial statements for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008 in its amended Form 10-K/A for the year ended December 31, 2007 and its amended Forms 10-Q/A for the quarterly periods ended March 31, 2008 and June 30, 2008. Within this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008, the Company has restated its condensed consolidated financial statements for the comparative three and nine month periods ended September 30, 2007 in conjunction with this restatement.

The restatement primarily relates to an error in the Company s interpretation and application of Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48), as its applies to a component of the Company s sales return reserve calculations. During the third quarter of 2008, management determined that its method of accounting for returns of short-dated and expired goods in the periods covered by the financial statements was not in conformity with generally accepted accounting principles, as the returns for expired product did not qualify for warranty or exchange accounting and, accordingly, under SFAS 48, the Company should have deferred the full sales price of the product for the amount of estimated returns.

The Company s prior accounting method with respect to sales return reserves accrued estimated future returns of short-dated and expired product, which were expected to be replaced with similar products, at replacement cost, based on the Company s view of the economic impact of returns on its business, rather than deferring the gross sales price. The replacement of short-dated and expired product,

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

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

The following is a summary of the effects of the restatement on the Company s condensed consolidated statements of operations for the three and nine months ended September 30, 2007 and its condensed consolidated statements of cash flows for the nine months ended September 30, 2007:

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CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
For the Three Months Ended September 30, 2007
(in thousands, except per share data)

	As Previously Reported	Restatement Adjustments	As Restated
Net product revenues	$ 116,532	$ (9,439)	$ 107,093
Net contract revenues	3,890		3,890
Net revenues	120,422	(9,439)	110,983
Cost of product revenues (1)	17,461	1,122	18,583
Gross profit	102,961	(10,561)	92,400
Operating expenses:			
Selling, general and administrative (2)	60,285	(1,408)	58,877
Research and development (3)	7,354		7,354
Depreciation and amortization	6,461		6,461
Operating income	28,861	(9,153)	19,708
Interest and investment income	9,842		9,842
Interest expense	(2,396)		(2,396)
Income before income tax	36,307	(9,153)	27,154
Income tax expense	13,547	(3,386)	10,161
Net income	$ 22,760	$ (5,767)	$ 16,993
Basic net income per share	$ 0.41	$ (0.11)	$ 0.30
Diluted net income per share	$ 0.34	$ (0.08)	$ 0.26
Cash dividend declared per common share	$ 0.03		$ 0.03
Basic common shares outstanding	56,120		56,120
Diluted common shares outstanding	71,155		71,155

(1) amount excludes amortization of intangible assets related to acquired products	$ 5,671	$ 5,671
(2) amount includes share-based compensation expense	$ 4,744	$ 4,744
(3) amount includes share-based compensation expense	$ (215)	$ (215)

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CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
For the Nine Months Ended September 30, 2007
(in thousands, except per share data)

	As Previously Reported	Restatement Adjustments	As Restated
Net product revenues	$ 314,805	$ (1,146)	$ 313,659
Net contract revenues	9,595		9,595
Net revenues	324,400	(1,146)	323,254
Cost of product revenues (1)	41,969	3,442	45,411
Gross profit	282,431	(4,588)	277,843
Operating expenses:			
Selling, general and administrative (2)	182,440	(3,728)	178,712
Impairment of intangible assets	4,067		4,067
Research and development (3)	22,508		22,508
Depreciation and amortization	17,793		17,793
Operating income	55,623	(860)	54,763
Interest and investment income	28,100		28,100
Interest expense	(7,622)		(7,622)
Income before income tax	76,101	(860)	75,241
Income tax expense	28,530	(503)	28,027
Net income	$ 47,571	$ (357)	$ 47,214
Basic net income per share	$ 0.85	$ (0.01)	$ 0.84
Diluted net income per share	$ 0.73	$	$ 0.73
Cash dividend declared per common share	$ 0.09		$ 0.09
Basic common shares outstanding	55,896		55,896
Diluted common shares outstanding	71,353		71,353
(1) amount excludes amortization of intangible assets related to acquired products	$ 15,634		$ 15,634
(2) amount includes share-based compensation expense	$ 15,646		$ 15,646
(3) amount includes share-based compensation expense	$ 40		$ 40

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CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
For the Nine Months Ended September 30, 2007
(in thousands)

	As Previously Reported	Restatement Adjustments	As Restated
Operating Activities:			
Net income	$ 47,571	$ (357)	$ 47,214
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	17,793		17,793
Amortization of deferred financing fees	1,249		1,249
Impairment of intangible assets	4,067		4,067
Loss on disposal of property and equipment	19		19
Gain on sale of available-for-sale investments	(49)		(49)
Share-based compensation expense	15,686		15,686
Deferred income tax expense	9,732	(404)	9,328
Tax benefit from exericise of stock options and vesting of restricted stock awards	2,664		2,664
Excess tax benefits from share-based payment arrangements	(1,365)		(1,365)
Decrease in provision for sales discounts and chargebacks	(14,877)	13,799	(1,078)
Amortization of (discount) premium on investments	(2,405)		(2,405)
Changes in operating assets and liabilities:			
Accounts receivable	35,952		35,952
Inventories	(1,526)		(1,526)
Other current assets	262		262
Accounts payable	3,030		3,030
Reserve for sales returns		(19,652)	(19,652)
Income taxes payable	(3,325)	(98)	(3,423)
Other current liabilities	2,557	6,712	9,269
Other liabilities	10,503		10,503
Net cash provided by operating activities	127,538		127,538
Investing Activities:			
Purchase of property and equipment	(7,195)		(7,195)
Payments for purchase of product rights	(30,090)		(30,090)
Purchase of available-for-sale investments	(570,463)		(570,463)
Sale of available-for-sale investments	173,014		173,014
Maturity of available-for-sale investments	173,396		173,396
Net cash used in investing activities	(261,338)		(261,338)
Financing Activities:			
Payment of dividends	(5,063)		(5,063)
Payment of contingent convertible senior notes	(5)		(5)
Excess tax benefits from share-based payment arrangements	1,365		1,365
Proceeds from the exercise of stock options	17,052		17,052
Net cash provided by financing activities	13,349		13,349

Effect of exchange rate on cash and cash equivalents	713		713
Net decrease in cash and cash equivalents	(119,738)		(119,738)
Cash and cash equivalents at beginning of period	203,319		203,319
Cash and cash equivalents at end of period	$ 83,581	$	$ 83,581

3. SHARE-BASED COMPENSATION

At September 30, 2008, the Company had seven active share-based employee compensation plans. Of these seven share-based compensation plans, only the 2006 Incentive Award Plan is eligible for the granting of future awards. Stock option awards granted from these plans are granted at the fair market value on the date of grant. The option awards vest over a period determined at the time the options are granted, ranging from one to five years, and generally have a maximum term of ten years. Certain options provide for accelerated vesting if

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there is a change in control (as defined in the plans). When options are exercised, new shares of the Company s Class A common stock are issued. Effective July 1, 2005, the Company adopted SFAS No. 123R using the modified prospective method. Other than restricted stock, no share-based employee compensation cost has been reflected in net income prior to the adoption of SFAS No. 123R.

The total value of the stock option awards is expensed ratably over the service period of the employees receiving the awards. As of September 30, 2008, total unrecognized compensation cost related to stock option awards, to be recognized as expense subsequent to September 30, 2008, was approximately $8.2 million and the related weighted-average period over which it is expected to be recognized is approximately 1.2 years.

A summary of stock options activity within the Company s stock-based compensation plans and changes for the nine months ended September 30, 2008 is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at December 31, 2007	11,666,955	$27.99		
Granted	127,702	$22.22		
Exercised	(278,492)	$15.59		
Terminated/expired	(724,458)	$31.26		
Balance at September 30, 2008	10,791,707	$28.02	4.0	$2,482,577

The intrinsic value of options exercised during the nine months ended September 30, 2008 was $1,914,487. Options exercisable under the Company s share-based compensation plans at September 30, 2008 were 9,864,369, with a weighted average exercise price of $27.44 a weighted average remaining contractual term of 3.8 years, and an aggregate intrinsic value of $2,482,577.

A summary of fully vested stock options and stock options expected to vest, based on historical forfeiture rates, as of September 30, 2008, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding	9,907,890	$28.20	4.0	$2,040,430
Exercisable	9,042,469	$27.64	3.9.	$2,040,430

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:

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Expected dividend yield	0.6% to 0.7%	0.4%
Expected stock price volatility	0.35 to 0.38	0.35
Risk-free interest rate	3.0% to 3.4%	4.5% to 4.8%
Expected life of options	7 Years	7 Years

The expected dividend yield is based on expected annual dividends to be paid by the Company as a percentage of the market value of the Company s stock as of the date of grant. The Company determined that a blend of implied volatility and historical volatility is more reflective of market conditions and a better indicator of expected volatility than using purely historical volatility. The risk-free interest rate is based on the U.S. treasury security rate in effect as of the date of grant. The expected lives of options are based on historical data of the Company.

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The weighted average fair value of stock options granted during the nine months ended September 30, 2008 and 2007 was $8.90 and $14.98, respectively.

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company s Class A common stock on the date of grant, and the total value of the award is expensed ratably over the service period of the employees receiving the grants. During the nine months ended September 30, 2008, 827,330 shares of restricted stock were granted to certain employees. Share-based compensation expense related to all restricted stock awards outstanding during the three months and nine months ended September 30, 2008, was approximately $1.7 million and $4.3 million, respectively. Share-based compensation expense related to all restricted stock awards outstanding during the three months and nine months ended September 30, 2007, was approximately $1.0 million and $2.8 million, respectively. As of September 30, 2008, the total amount of unrecognized compensation cost related to non-vested restricted stock awards, to be recognized as expense subsequent to September 30, 2008, was approximately $24.3 million, and the related weighted-average period over which it is expected to be recognized is approximately 3.7 years.

A summary of restricted stock activity within the Company s share-based compensation plans and changes for the six months ended September 30, 2008 is as follows:

Non-vested Shares	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at December 31, 2007	552,769	$31.92
Granted	827,330	$19.51
Vested	(122,222)	$31.57
Forfeited	(50,677)	$25.31
Non-vested at September 30, 2008	1,207,200	$23.73

The total fair value of restricted shares vested during the nine months ended September 30, 2008 and the nine months ended September 30, 2007 was approximately $3.9 million and $1.3 million, respectively.

4. SHORT-TERM AND LONG-TERM INVESTMENTS

The Company s short-term and long-term investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to the Company s investment guidelines and market conditions. Short-term and long-term investments consist of corporate and various government agency and municipal debt securities. The Company s investments in auction rate floating securities consist primarily of investments in student loans. Management classifies the Company s short-term and long-term investments as available-for-sale. Available-for-sale securities are carried at fair value with unrealized gains and losses reported in stockholders equity. Realized gains and losses and declines in value judged to be other than temporary, if any, are included in operations. A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary, results in an impairment in the fair value of the investment. The impairment is charged to earnings and a new cost basis for the security is established. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security. Dividends and interest income are recognized when earned. The cost of securities sold is calculated using the specific identification method. At September 30, 2008, the Company has recorded the estimated fair value in available-for-sale securities for short-term and long-term investments of approximately $248.1 million and $93.4 million, respectively.

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Available-for-sale securities consist of the following at September 30, 2008 (amounts in thousands):

	SEPTEMBER 30, 2008			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate notes and bonds	$ 97,678	$ 94	$ (1,444)	$ 96,328
Federal agency notes and bonds	168,405	461	(170)	168,696
Auction rate floating securities	44,750		(4,825)	39,925
Asset-backed securities	36,944	48	(395)	46,597
Commercial paper				
Total securities	$ 347,777	$ 603	$ (6,834)	$ 341,546

During the three months and nine months ended September 30, 2008, the gross realized gains on sales of available-for-sale securities totaled $73,275 and $1,134,731, respectively, while gross losses of $0 and $114,034, respectively, were realized. Such amounts of gains and losses are determined based on the specific identification method. The net adjustment to unrealized losses during the three months and nine months ended September 30, 2008, on available-for-sale securities included in stockholders equity totaled $3,387,942 and $4,680,781, respectively. The amortized cost and estimated fair value of the available-for-sale securities at September 30, 2008, by maturity, are shown below (amounts in thousands):

	SEPTEMBER 30, 2008	
	Cost	Estimated Fair Value
Available-for-sale		
Due in one year or less	$ 215,575	$ 214,765
Due after one year through five years	87,452	86,856
Due after five years through 10 years		
Due after 10 years	44,750	39,925
	$ 347,777	$ 341,546

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 September 30, 2008, approximately $93.4 million in estimated fair value expected to mature greater than one year has been classified as long-term investments because these investments are in an unrealized loss position, and it is management s intent to hold these investments until recovery of fair value, which may be maturity.

As of September 30, 2008, the Company s investments included auction rate floating securities with a fair value of $39.9 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 recent negative conditions in the credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008, the Company was informed that there was insufficient demand at auction for the auction rate floating securities. As a result, these affected auction rate floating securities are now considered illiquid, and the Company could be required to hold them until they are redeemed by the holder at maturity. The Company may not be able to make the securities liquid until a future auction on these investments is successful. As a result of the lack of liquidity of these investments, the Company recorded unrealized losses of $0.8 million during the three months ended March 31, 2008, $0.5 million during the three months ended

June 30, 2008 and $3.5 million during the three months ended September 30, 2008 on its auction rate floating securities in accumulated other comprehensive (loss) income.

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The following table shows the gross unrealized losses and fair value of the Company s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2008 (amounts in thousands):

	Less Than 12 Months		Greater Than 12 Months	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Corporate notes and bonds	$ 70,475	$ 1,345	$ 11,400	$ 100
Federal agency notes and bonds	79,365	170		
Auction rate floating securities	39,925	4,825		
Asset-backed securities	12,718	43	2,394	352
Total securities	$ 202,483	$ 6,383	$ 13,794	$ 452

As of September 30, 2008, the Company has concluded that the unrealized losses on its investment securities are temporary in nature. 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 length of time the fair value has been below cost, the expectation for that security s performance and the creditworthiness of the issuer. The Company believes that the changes in the unrealized losses on the securities were caused by changes in credit spreads and liquidity issues in the marketplace and other-than-temporary impairments do not exist. Additionally, the Company has the intent and ability to hold these investments for the time necessary to recover its cost, which for debt securities may be at maturity.

5. FAIR VALUE MEASUREMENTS

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

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

As of September 30, 2008, the Company held certain assets that are required to be measured at fair value on a recurring basis. These included certain of the Company s short-term and long-term investments, including investments in auction rate floating securities, and the Company s investment in Revance Therapeutics, Inc. (Revance).

The Company has invested in auction rate floating securities, which are classified as available-for-sale securities and are reflected at fair value. However, due to recent events in credit markets, the auction events for some of these instruments held by the Company failed during the three months ended March 31, 2008 (see Note 4). Therefore, the fair values of these auction rate floating securities are estimated utilizing a discounted cash flow analysis as of September 30, 2008. These analyses consider, among other items, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These investments were also compared, when possible, to other observable market data with similar characteristics to the securities held by the Company. Changes to these assumptions in future periods could result in additional declines in fair value of the auction rate floating securities.

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As a result of the temporary declines in fair value for the Company s auction rate floating securities, which the Company attributes to liquidity issues rather than credit issues, it has recorded an unrealized loss of $4.8 million in accumulated other comprehensive (loss) income. The majority of the auction rate floating securities held by the Company at September 30, 2008, totaling $39.9 million, were in securities collateralized by student loan portfolios. These securities were included in long-term investments at September 30, 2008 in the accompanying condensed consolidated balance sheets. As of September 30, 2008, the Company continued to earn interest on virtually all of its auction rate floating securities. Any future fluctuation in fair value related to these investments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive (loss) income. If the Company determines that any future valuation adjustment was other than temporary, it would record a charge to earnings as appropriate.

The Company estimates changes in the net realizable value of its investment in Revance based on a hypothetical liquidation at book value approach (see Note 8). During the three and nine month periods ended September 30, 2008, the Company reduced the carrying value of its investment in Revance and recorded a related charge to earnings of approximately $2.6 million and $5.5 million, respectively, as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of September 30, 2008.

The Company s assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS No. 157 at September 30, 2008, were as follows (in thousands):

		Fair Value Measurement at Reporting Date Using		
	Sept. 30, 2008	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Auction rate floating securities	$ 39,925	$	$	$ 39,925
Other available-for-sale securities	301,621	301,621		
Investment in Revance	6,492			6,492
Total assets measured at fair value	$ 348,038	$ 301,621	$	$ 46,417

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

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The following table presents the Company s assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in SFAS No. 157 for the three and nine months ended September 30, 2008 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Auction Rate Floating Securities	Investment in Revance
Balance at June 30, 2008	$ 43,620	$ 9,086
Transfers to Level 3		
Total gains (losses) included in earnings		(2,594)
Total gains (losses) included in other comprehensive (loss) income	(3,545)	
Purchases and settlements (net)	(150)	
Balance at September 30, 2008	$ 39,925	$ 6,492

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Auction Rate Floating Securities	Investment in Revance
Balance at January 1, 2008	$	$ 11,957
Transfers to Level 3	101,650	
Total gains (losses) included in earnings		(5,465)
Total gains (losses) included in other comprehensive (loss) income	(4,825)	
Purchases and settlements (net)	(56,900)	
Balance at September 30, 2008	$ 39,925	$ 6,492

6. ACQUISITION OF LIPOSONIX

On July 1, 2008, the Company, through its wholly-owned subsidiary Donatello, Inc., acquired LipoSonix, Inc. (LipoSonix), an independent, privately-held company that employs a staff of approximately 40 scientists, engineers and clinicians located near Seattle, Washington. LipoSonix is a medical device company developing non-invasive body sculpting technology, and recently launched its first product in Europe, where it is being marketed and sold through distributors. The LipoSonix technology is currently not approved for sale or use in the United States.

Under terms of the transaction, Medicis paid $150 million in cash for all of the outstanding shares of LipoSonix. In addition, Medicis will pay LipoSonix stockholders certain milestone payments up to an additional $150 million upon FDA approval of the LipoSonix technology and if various commercial milestones are achieved on a worldwide basis.

The following is a summary of the components of the LipoSonix purchase price (in millions):

Cash consideration	$ 150.0
Transaction costs	3.6
	$ 153.6

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The following is a summary of the estimated fair values of the net assets acquired (in millions):

Current assets	$ 2.1
Deferred tax assets, short-term	3.8
Deferred tax assets, long-term	14.9
Property and equipment	0.7
Identifiable intangible assets	9.4
In-process research and development	30.5
Goodwill	93.7
Accounts payable and other current liabilities	(1.5)
	$ 153.6

The Company believes the fair values assigned to the assets acquired and liabilities assumed are based on reasonable assumptions.

Identifiable intangible assets of $9.4 million include existing technology of $6.7 million, with an estimated amortizable life of ten years, and trademarks and trade names of $2.7 million, with an estimated indefinite amortizable life.

The $30.5 million of acquired in-process research and development has been recognized as in-process research and development expense in the Company s statement of operations during the three months ended September 30, 2008. No tax benefit has been recognized related to this charge.

The results of operations of LipoSonix are included in the Company s condensed consolidated financial statements beginning on July 1, 2008.

Unaudited pro forma financial information for the combined Company, assuming the Company s acquisition of LipoSonix occurred on January 1, 2007, excluding the in-process research and development charge, is as follows (in millions, except per share data):

	Nine Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Net revenues	$ 382.5	$ 111.0	$ 323.3
Net income	7.7	14.5	39.4
Diluted net income per share	$ 0.13	$ 0.22	$ 0.62

7. STRATEGIC COLLABORATION

On June 27, 2008, the Company and a U.S. company entered into a license agreement that provides patent rights for development and commercialization of dermatologic products. Under terms of the agreement, the Company made an initial payment of $2.0 million upon execution of the agreement. In addition, the Company will be required to pay $19.0 million upon successful completion of certain clinical milestones, $15.0 million upon the first commercial sales of the products in the U.S. and $30.0 million upon achievement of certain commercial milestones. The Company will also make royalty payments based on net sales as defined in the license. The $2.0 million payment was recognized as a charge to research and development expense during the three months ended June 30, 2008.

8. INVESTMENT IN REVANCE

On December 11, 2007, the Company announced a strategic collaboration with Revance, a privately-held, venture-backed development-stage entity, whereby the Company made an equity investment in Revance and purchased an option to acquire Revance or to license exclusively in North America Revance s novel topical botulinum toxin type A product currently under clinical development. The consideration to be paid to Revance upon the Company s exercise of the option will be at an amount that will approximate the then fair value of Revance or the license of the product under development, as determined by an independent appraisal. The option period will extend

through the end of Phase 2 testing

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in the United States. In consideration for the Company s $20.0 million payment, the Company received preferred stock representing an approximate 13.7 percent ownership in Revance, or approximately 11.7 percent on a fully diluted basis, and the option to acquire Revance or to license the product under development. The $20.0 million is expected to be used by Revance primarily for the development of the product. $12.0 million of the $20.0 million payment represents the fair value of the investment in Revance at the time of the investment and is included in other long-term assets in the Company s condensed consolidated balance sheets as of December 31, 2007. The remaining $8.0 million, which is non-refundable and is expected to be utilized in the development of the new product, represents the residual value of the option to acquire Revance or to license the product under development and was recognized as research and development expense during the three months ended December 31, 2007.

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

The Company estimates the impairment and/or the net realizable value of the investment based on a hypothetical liquidation at book value approach as of the reporting date, unless a quantitative valuation metric is available for these purposes (such as the completion of an equity financing by Revance). The amount of the Company s investment that will be expensed periodically is uncertain due to the timing of Revance s expenditures for research and development of the product, and any charges will not be immediately, if ever, deductible for income tax purposes and will increase the Company s effective tax rate. Further equity investments, if any, will also be subject to the same accounting treatment as the Company s original equity investment. During the three and nine month periods ended September 30, 2008, the Company reduced the carrying value of its investment in Revance and recorded a related charge to earnings of approximately $2.6 million and $5.5 million, respectively, as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of September 30, 2008.

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

9. DEVELOPMENT AND DISTRIBUTION AGREEMENT WITH IPSEN FOR RIGHTS TO IPSEN S BOTULINUM TOXIN TYPE A PRODUCT KNOWN AS RELOXIN®

On March 17, 2006, the Company entered into a development and distribution agreement with Ipsen Ltd., a wholly-owned subsidiary of Ipsen, S.A. (Ipsen), whereby Ipsen granted Aesthetica Ltd., a wholly-owned subsidiary of Medicis, rights to develop, distribute and commercialize Ipsen s botulinum toxin type A product in the United States, Canada and Japan for aesthetic use by physicians. The product is commonly referred to as RELOXIN® in the U.S. aesthetic market and DYSPORT® in medical and

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aesthetic markets outside the U.S. The product is not currently approved for use in the U.S., Canada or Japan.

In May 2008, the FDA accepted the filing of Ipsen s Biologics License Application for RELOXIN®, and in accordance with the agreement, Medicis paid Ipsen $25.0 million during the three months ended June 30, 2008 upon achievement of this milestone. The $25.0 million was recognized as a charge to research and development expense during the three months ended June 30, 2008.

Medicis will pay an additional $1.5 million upon the successful completion of a regulatory milestone, $75.0 million upon the product s approval by the FDA and $2.0 million upon regulatory approval of the product in Japan. Ipsen will manufacture and provide the product to Medicis for the term of the agreement, which extends to December 2036. Ipsen will receive a royalty based on sales and a supply price, the total of which is equivalent to approximately 30% of net sales as defined under the agreement. Under the terms of the agreement, Medicis is responsible for all remaining research and development costs associated with obtaining the product s approval in the U.S., Canada and Japan.

10. IMPAIRMENT OF LONG-LIVED ASSETS

The Company assesses the potential impairment of long-lived assets on a periodic basis and when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Factors that the Company considers in deciding when to perform an impairment review include significant under-performance of a product line in relation to expectations, significant negative industry or economic trends, and significant changes or planned changes in the Company s use of the assets. Recoverability of assets that will continue to be used in the Company s operations is measured by comparing the carrying amount of the asset grouping to the Company s estimate of the related total future net cash flows. If an asset carrying value is not recoverable through the related cash flows, the asset is considered to be impaired. The impairment is measured by the difference between the asset grouping s carrying amount and its fair value, based on the best information available, including market prices or discounted cash flow analysis. If the assets determined to be impaired are to be held and used, the Company recognizes an impairment loss through a charge to operating results to the extent the present value of anticipated net cash flows attributable to the asset are less than the asset s carrying value. When it is determined that the useful life of assets are shorter than originally estimated, and there are sufficient cash flows to support the carrying value of the assets, the Company will accelerate the rate of amortization charges in order to fully amortize the assets over their new shorter useful lives.

During the quarter ended June 30, 2007, an intangible asset related to OMNICEF® was determined to be impaired based on the Company s analysis of the intangible asset s carrying value and projected future cash flows. As a result of the impairment analysis, the Company recorded a write-down of approximately $4.1 million related to this intangible asset.

Factors affecting the future cash flows of the OMNICEF® intangible asset included an early termination letter received during May 2007 from Abbott Laboratories, Inc. (Abbott), which, in accordance with the Company s agreement with Abbott, transitions the Company s co-promotion agreement into a two-year residual period, and competitive pressures in the marketplace, including generic competition.

In addition, as a result of the impairment analysis, the remaining amortizable life of the intangible asset related to OMNICEF® was reduced to two years. The intangible asset related to OMNICEF® will become fully amortized by June 30, 2009. The net impact on amortization expense as a result of the write-down of the carrying value of the intangible asset and the reduction of its amortizable life is a decrease in quarterly amortization expense of approximately $126,000.

11. SEGMENT AND PRODUCT INFORMATION

The Company operates in one significant business segment: pharmaceuticals. The Company s current pharmaceutical franchises are divided between the dermatological and non-dermatological fields. The dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. The non-dermatological field represents products for

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the treatment of urea cycle disorder and contract revenue. The acne and acne-related dermatological product lines include DYNACIN®, PLEXION®, SOLODYN®, TRIAZ® and ZIANA®. The non-acne dermatological product lines include LOPROX®, PERLANE®, RESTYLANE® and VANOS®. The non-dermatological product lines include AMMONUL® and BUPHENYL®. The non-dermatological field also includes contract revenues associated with licensing agreements and authorized generics.

The Company s pharmaceutical products, with the exception of AMMONUL® and BUPHENYL®, are promoted to dermatologists, podiatrists and plastic surgeons. Such products are often prescribed by physicians outside these three specialties; including family practitioners, general practitioners, primary-care physicians and OB/GYNs, as well as hospitals, government agencies and others. Currently, all products are sold primarily to wholesalers and retail chain drug stores.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007 (Restated)	2008	2007 (Restated)
Acne and acne-related dermatological products	$ 66,289	$ 56,180	$ 232,806	$ 166,003
Non-acne dermatological products	34,080	43,778	113,695	130,085
Non-dermatological products	15,056	11,024	35,278	27,166
Total net revenues	$ 115,425	$ 110,982	$ 381,779	$ 323,254

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007 (Restated)	2008	2007 (Restated)
Acne and acne-related dermatological products	57%	51%	61%	52%
Non-acne dermatological products	30	39	30	40
Non-dermatological products	13	10	9	8
Total net revenues	100%	100%	100%	100%

12. 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 September 30, 2008, there was approximately $0.6 million of costs capitalized into inventory for products that have not yet received regulatory approval. As of December 31, 2007, there were no costs capitalized into inventory for products that have not yet received regulatory approval.

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Inventories consist of the following at September 30, 2008 and December 31, 2007 (amounts in thousands):

	September 30, 2008	December 31, 2007
Raw materials	$ 7,637	$ 9,002
Finished goods	18,981	24,789
Valuation reserve	(1,185)	(3,818)
Total inventories	$ 25,433	$ 29,973

13. CONTINGENT CONVERTIBLE SENIOR NOTES

In June 2002, the Company sold $400.0 million aggregate principal amount of its 2.5% Contingent Convertible Senior Notes Due 2032 (the Old Notes) in private transactions. As discussed below, approximately $230.8 million in principal amount of the Old Notes was exchanged for New Notes on August 14, 2003. The Old Notes bear interest at a rate of 2.5% per annum, which is payable on June 4 and December 4 of each year, beginning on December 4, 2002. The Company also agreed to pay contingent interest at a rate equal to 0.5% per annum during any six-month period, with the initial six-month period commencing June 4, 2007, if the average trading price of the Old Notes reaches certain thresholds. No contingent interest related to the Old Notes was payable at June 30, 2008 or December 31, 2007. The Old Notes will mature on June 4, 2032.

The Company may redeem some or all of the Old Notes at any time on or after June 11, 2007, at a redemption price, payable in cash, of 100% of the principal amount of the Old Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the Old Notes may require the Company to repurchase all or a portion of their Old Notes on June 4, 2012 and June 4, 2017, or upon a change in control (as defined in the indenture governing the Old Notes) at 100% of the principal amount of the Old Notes, plus accrued and unpaid interest, and contingent interest, if any, to the date of the repurchase, payable in cash. Pursuant to SFAS No. 48, *Classification of Obligations That Are Callable by the Creditor*, if an obligation is due on demand or will be due on demand within one year from the balance sheet date, even though liquidation may not be expected within that period, it should be classified as a current liability. Accordingly, the outstanding balance of Old Notes along with the deferred tax liability associated with accelerated interest deductions on the Old Notes will be classified as a current liability during the respective twelve month periods prior to June 4, 2012 and June 4, 2017.

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

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

if the Company has called the Old Notes for redemption;

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

upon the occurrence of specified corporate transactions.

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

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

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

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

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

Holders of the New Notes were able to require the Company to repurchase all or a portion of their New Notes on June 4, 2008, at 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash. Holders of approximately $283.7 million of New Notes elected to require the Company to repurchase their New 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 New Notes that elected to require the Company to repurchase their New Notes. The Company was also required to pay an accumulated deferred tax liability of approximately $34.9 million related to the repurchased New Notes. Approximately $26.2 million of this $34.9 million deferred tax liability, which was included in income taxes payable as of June 30, 2008, was paid during the three months ended September 30, 2008. The remaining $8.7 million of this deferred tax liability will be paid during the three months ended December 31, 2008. Following the repurchase of these New Notes, $181,000 of principal amount of New Notes remained outstanding as of June 30, 2008 and September 30, 2008. The Company intends to redeem the remaining $181,000 of principal amount of New Notes during the fourth quarter of 2008 or during 2009, when practicable.

The Company may redeem some or all of the remaining New Notes at any time on or after June 11, 2008, at a redemption price, payable in cash, of 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any. Holders of the remaining New Notes may require the Company to repurchase all or a portion of their remaining New Notes on June 4, 2013 and June 4, 2018, and upon a change in control (as defined in the indenture governing the New Notes), at 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash.

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

during any quarter commencing after September 30, 2003, if the closing price of the Company s Class A common stock over a specified number of trading days during the previous quarter, including the last trading day of such quarter, is more than 120% of the conversion price of the New Notes, or $46.51. The Notes are initially convertible at a conversion price of $38.76 per

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share, which is equal to a conversion rate of approximately 25.7998 shares per $1,000 principal amount of New Notes, subject to adjustment;

if the Company has called the New Notes for redemption;

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

upon the occurrence of specified corporate transactions.

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

During the quarter ended December 31, 2006, the Old Notes met the criteria for the right of conversion into shares of the Company s Class A common stock. This right of conversion of the holders of Old Notes was triggered by the Company s Class A common stock closing above $31.96 on 20 of the last 30 trading days and the last trading day of the quarter ended December 31, 2006. The holders of Old Notes had this conversion right only until March 31, 2007. During the three months ended March 31, 2007, outstanding principal amounts of $5,000 of Old Notes were converted into shares of the Company s Class A common stock. During the quarters ended September 30, 2008, June 30, 2008, March 31, 2008 and December 31, 2007, the Old Notes and New Notes did not meet the criteria for the right of conversion. At the end of each future quarter, the conversion rights will be reassessed in accordance with the bond indenture agreement to determine if the conversion trigger rights have been achieved.

14. INCOME TAXES

Income taxes are determined using an annual effective tax rate, which generally differs from the U.S. Federal statutory rate, primarily because of state and local income taxes, enhanced charitable contribution deductions for inventory, tax credits available in the U.S., the treatment of certain share-based payments under SFAS 123R that are not designed to normally result in tax deductions, various expenses that are not deductible for tax purposes, changes in valuation allowances against deferred tax assets, and differences in tax rates in certain non-U.S. jurisdictions. The Company s effective tax rate may be subject to fluctuations during the year as new information is obtained which may affect the assumptions it uses to estimate its annual effective tax rate, including factors such as its mix of pre-tax earnings in the various tax jurisdictions in which it operates, changes in valuation allowances against deferred tax assets, reserves for tax audit issues and settlements, utilization of tax credits and changes in tax laws in jurisdictions where the Company conducts operations. The Company recognizes tax benefits in accordance with FIN 48. Under FIN 48, tax benefits are recognized 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 deferred tax assets to reduce the net carrying value to amounts that management believes is more likely than not to be realized.

At September 30, 2008 the Company has an unrealized tax loss of $14.8 million related to the Company s option to acquire Revance or license Revance s product that is under development. The Company has currently assessed that the unrealized loss would result in a capital loss carryover if realized. Due to tax limitations on the utilization of capital loss carryovers, the Company recorded a valuation allowance of $3.3 million against the capital loss carryover as of December 31, 2007. The valuation allowance increased $2.0 million to $5.3 million during the nine months ended September 30, 2008.

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During the three months ended September 30, 2008 and September 30, 2007, the Company made net tax payments of $36.9 million and $2.5 million, respectively. During the nine months ended September 30, 2008 and September 30, 2007, the Company made net tax payments of $67.1 million and $19.7 million, respectively.

The Company operates in multiple tax jurisdictions and is periodically subject to audit in these jurisdictions. These audits can involve complex issues that may require an extended period of time to resolve and may cover multiple years. The Company and its domestic subsidiaries file a consolidated U.S. federal income tax return. Such returns have either been audited or settled through statute expiration through fiscal 2004. The Internal Revenue Service is currently conducting a limited scope examination of the Company s tax return for the six-month Transition Period ending December 31, 2005. To date, no adjustments have been proposed.

The Company owns two subsidiaries that file corporate tax returns in Sweden. The Swedish tax authorities examined the tax return of one of the subsidiaries for fiscal 2004. The examiners issued a no change letter, and the examination is complete. The Company s other subsidiary in Sweden has not been examined by the Swedish tax authorities. The Swedish statute of limitation may be open for up to five years from the date the tax return was filed. Thus, all returns filed since this entity s formation in fiscal 2003 are open under the statute of limitation.

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

At December 31, 2007, the Company had $3.4 million in unrecognized tax benefits, the recognition of which would have a favorable effect of $2.7 million on the Company s effective tax rate. The amount of unrecognized tax benefits decreased $0.9 million from $3.4 million to $2.5 million during the nine months ended September 30, 2008 as part of the settlement with the Arizona Department of Revenue. Recognition of the $2.5 million unrecognized tax benefits would have a favorable effect of $2.1 million on the Company s effective tax rate. During the next twelve months, the Company estimates that it is reasonably possible that the liability for unrecognized tax benefits may decrease by $1.3 million.

The Company recognizes accrued interest and penalties, if applicable, related to unrecognized tax benefits in income tax expense. The Company has accrued approximately $280,000 and $265,000 (net of tax benefits) for the payment of interest and penalties at December 31, 2007, and September 30, 2008, respectively.

15. DIVIDENDS DECLARED ON COMMON STOCK

On September 17, 2008, the Company declared a cash dividend of $0.04 per issued and outstanding share of its Class A common stock payable on October 31, 2008 to stockholders of record at the close of business on October 1, 2008. The $2.3 million dividend was recorded as a reduction of accumulated earnings and is included in other current liabilities in the accompanying condensed consolidated balance sheets as of September 30, 2008.

16. SHARE REPURCHASE PROGRAM

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

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17. COMPREHENSIVE (LOSS) INCOME

Total comprehensive (loss) income includes net (loss) income and other comprehensive (loss) income, which consists of foreign currency translation adjustments and unrealized gains and losses on available-for-sale investments. Total comprehensive (loss) income for the three months and nine months ended September 30, 2008 was $(18.1) million and $14.1 million, respectively. Total comprehensive income for the three months and nine months ended September 30, 2007 was $18.0 million and $48.4 million, respectively.

18. NET (LOSS) INCOME PER COMMON SHARE

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007 (Restated)	2008	2007 (Restated)
BASIC				
Net (loss) income	$ (14,657)	$ 16,993	$ 18,878	$ 47,215
Weighted average number of common shares outstanding	56,698	56,120	56,517	55,896
Basic net (loss) income per common share	$ (0.26)	$ 0.30	$ 0.33	$ 0.84
DILUTED				
Net (loss) income	$ (14,657)	$ 16,993	$ 18,878	$ 47,215
Add:				
Tax-effected interest expense and issue costs related to Old Notes		669		2,284
Tax-effected interest expense and issue costs related to New Notes		841		2,518
Net (loss) income assuming dilution	$ (14,657)	$ 18,503	$ 18,878	$ 52,017
Weighted average number of common shares	56,698	56,120	56,517	55,896
Effect of dilutive securities:				
Old Notes		5,823		5,823
New Notes		7,325		7,325
Stock options and restricted stock		1,887	841	2,309
Weighted average number of common shares assuming dilution	56,698	71,155	57,358	71,353

Diluted net (loss) income per common share	$ (0.26)	$ 0.26	$ 0.33	$ 0.73

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

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Due to the Company s net loss during the three months ended September 30, 2008, a calculation of diluted earnings per share is not required. For the three months ended September 30, 2008, potentially dilutive securities consisted of restricted stock and stock options convertible into 633,923 shares in the aggregate, and 5,822,551 and 4,685 shares of common stock, issuable upon conversion of the Old Notes and New Notes, respectively.

The diluted net income per common share computation for the nine months ended September 30, 2008 excludes 9,947,263 shares of stock that represented outstanding stock options whose exercise price were greater than the average market price of the common shares during the period and were anti-dilutive. The diluted net income per common share computation for the nine months ended September 30, 2008 also excludes 5,822,551 and 4,172,353 shares of common stock, issuable upon conversion of the Old Notes and New Notes, respectively, as they were anti-dilutive.

The diluted net income per common share computation for the three and nine months ended September 30, 2007 excludes 3,509,873 and 3,599,647 shares of stock that represented outstanding stock options whose exercise price were greater than the average market price of the common shares during the period and were anti-dilutive.

19. COMMITMENTS AND CONTINGENCIES

Lease Exit Costs

During July 2006, the Company executed a lease agreement for new headquarter office space. The first phase is for approximately 150,000 square feet with the right to expand. The term of the lease is twelve years. Occupancy of the new headquarter office space, which is located approximately one mile from the Company s prior headquarter office space in Scottsdale, Arizona, occurred in the quarter ended September 30, 2008.

In connection with occupancy of the new headquarter office, the Company ceased use of the prior headquarter office in July 2008, which consists of approximately 75,000 square feet of office space, at an average annual expense of approximately $2.1 million, under an amended lease agreement that expires in December 2010. The Company has adopted SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, effective for exit or disposal activities initiated after December 31, 2002. Under SFAS 146, a liability for the costs associated with an exit or disposal activity is recognized when the liability is incurred. In accordance with SFAS 146, the Company recorded lease exit costs of approximately $4.8 million during the three months ended September 30, 2008 consisting of the initial liability of $4.7 million and accretion expense of $0.1 million. These amounts were recorded as selling, general and administrative expenses in the Company s condensed consolidated statements of operations. The Company has not recorded any other costs related to the lease for the prior headquarters.

As of September 30, 2008, approximately $4.5 million of lease exit costs remain accrued and are expected to be paid by December 2010 of which $1.9 million is classified in other current liabilities and $2.6 million is classified in other liabilities. Although the facilities are no longer in use by the Company, the lease exit cost accrual has not been offset by an adjustment for estimated sublease rentals. After considering sublease market information as well as factors specific to the lease, the Company concluded it was probable it would be unable to reasonably obtain sublease rentals for the prior headquarters and therefore it would not be subleased for the remaining lease term. The Company will continue to monitor the sublease market conditions and reassess the impact on the lease exit cost accrual.

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The following is a summary of the activity in the liability for lease exit costs for the three months ended September 30, 2008:

	Liability as of June 30, 2008	Amounts Charged to Expense	Cash Payments Made	Cash Received from Sublease	Liability as of Sept. 30, 2008
Lease exit costs liability	$	$ 4,812,928	$ (356,352)	$	$ 4,456,576

Legal Matters

On October 3, 10, and 27, 2008, purported stockholder class action lawsuits styled Andrew Hall v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01821-MHB); Steamfitters Local 449 Pension Fund v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01870-DKD); and Darlene Oliver v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01964-JAT) were filed in the United States District Court for the District of Arizona on behalf of stockholders who purchased securities of the Company during the period between October 30, 2003 and approximately September 24, 2008. The complaints name as defendants Medicis Pharmaceutical Corp. and the Company s Chief Executive Officer and Chairman of the Board, Jonah Shacknai, the Company s Chief Financial Officer, Executive Vice President and Treasurer, Richard D. Peterson, and the Company s Chief Operating Officer and Executive Vice President, Mark A. Prygocki. Plaintiffs claims arise in connection with the restatement of the Company s annual, transition, and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008. The complaints allege violations of federal securities laws, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5, based on alleged material misrepresentations to the market that had the effect of artificially inflating the market price of the Company s stock. The plaintiffs seek to recover unspecified damages and costs, including counsel and expert fees. The Company has discussed the matters relating to the restatement with the SEC s Division of Enforcement and has committed to cooperating fully with the SEC in connection with any questions they may have.

On April 30, 2008, the Company received notice from Perrigo Israel Pharmaceuticals Ltd. (Perrigo Israel), a generic pharmaceutical company, that it had filed an Abbreviated New Drug Application with the FDA for a generic version of the Company s VANOS® fluocinonide cream 0.1%. Perrigo Israel s notice indicated that it was challenging only one of the two patents that the Company listed with the FDA for VANOS® cream. On June 6, 2008, the Company filed a complaint for patent infringement against Perrigo Israel and its domestic corporate parent Perrigo Company in the United States District Court for the Western District of Michigan. The complaint asserts that Perrigo Israel and Perrigo Company have infringed both of the Company s patents for VANOS® Cream.

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

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

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On May 25, 2006, Prasco Laboratories of Cincinnati, Ohio filed suit against the Company and Imaginative Research Associates (IRA) seeking a declaration that Prasco s Oscion product does not infringe certain patents owned by the Company or by IRA. The Company and IRA moved to dismiss that suit on the grounds that the court had no jurisdiction under the Declaratory Judgment Act to hear the case. The court granted the Company s motion and dismissed the case. Prasco has appealed and the appeal is pending before the U.S. Court of Appeals for the Federal Circuit. The case was argued to the U.S. Court of Appeals on April 10, 2008.

In addition to the matters discussed above, in the ordinary course of business, the Company is involved in a number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. Although the outcome of these actions is not presently determinable, it is the opinion of the Company s management, based upon the information available at this time, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the results of operations or financial condition of the Company.

20. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which replaces SFAS No. 141 and establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any controlling interest. It also established principles and requirements for how an acquirer in a business combination recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R provides for the following changes from SFAS No. 141: 1) an acquirer will record all assets and liabilities of acquired business, including goodwill, at fair value, regardless of the level of interest acquired; 2) certain contingent assets and liabilities acquired will be recognized at fair value at the acquisition date; 3) contingent consideration will be recognized at fair value on the acquisition date with changes in fair value to be recognized in earnings upon settlement; 4) acquisition-related transaction and restructuring costs will be expensed as incurred rather than treated as part of the cost of the acquisition and included in the amount recorded for assets acquired; 5) reversals of valuation allowances related to acquired deferred tax assets and changes to acquired income tax uncertainties will be recognized in earnings; and 6) when making

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adjustments to finalize initial accounting, acquirers will revise any previously issued post-acquisition financial information in future financial statements to reflect any adjustments as if they occurred on the acquisition date. The Company will apply SFAS No. 141R to business combinations for which the acquisition date is on or after January 1, 2009. The Company is currently evaluating SFAS No. 141R and its impact, if any, on the Company s consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51*. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest, or minority interest, as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the statement of operations. SFAS No. 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains it controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating SFAS No. 160 and its impact, if any, on its consolidated results of operations and financial condition.

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

In April 2008, the FASB issued FSP 142-3, *Determination of the Useful Life of Intangible Assets*. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating FSP 142-3 and its impact, if any, on its consolidated results of operations and financial condition.

In May 2008, the FASB issued FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 clarifies the accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. FSP APB 14-1 specifies that issuers of such instruments should separately account for the liability and equity components of certain convertible debt instruments in a manner that reflects the issuer s nonconvertible debt borrowing rate when interest cost is recognized. FSP APB 14-1 requires bifurcation of a component of the debt, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense. FSP APB 14-1 requires retrospective application to the terms of instruments as they existed for all periods presented. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008, and early adoption is not permitted. The Company does not expect FSP APB 14-1 to impact its consolidated results of operations and financial condition.

In June 2008, the FASB reached a consensus on EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock*. EITF 07-5 addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity s own stock. EITF 07-5 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating EITF 07-5 and the impact, if any, on its consolidated results of

operations and financial condition.

In October 2008, the FASB issued FSP 157-3*, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active.* FSP 157-3 clarifies the application of SFAS No. 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining fair value of financial assets when the market for that financial asset is not active. FSP 157-3

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applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with SFAS No. 157. FSP 157-3 was effective upon issuance and included prior periods for which financial statements had not been issued. The application of FSP 157-3 did not have a material impact on the Company s consolidated financial statements.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Restatement

On November 10, 2008, we restated our financial statements for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008 in our amended Form 10-K/A for the year ended December 31, 2007 and our amended Forms 10-Q/A for the quarterly periods ended March 31, 2008 and June 30, 2008. Within this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008, we have restated our condensed consolidated financial statements for the comparative three and nine month periods ended September 30, 2007 in conjunction with this restatement.

The restatement primarily relates to an error in our interpretation and application of Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48), as it applies to a component of our sales return reserve calculations. During the third quarter of 2008, management determined that the method of accounting for returns of short dated and expired goods in the periods covered by the financial statements was not in conformity with generally accepted accounting principles, as the returns for expired product did not qualify for warranty or exchange accounting and, accordingly, under SFAS 48, the Company should have deferred the full sales price of the product for the amount of estimated returns.

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

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

Note 2 to our condensed consolidated financial statements discloses the nature of the restatement adjustments and details the impact of the restatement adjustments on our condensed consolidated financial statements for the three and nine months ended September 30, 2007.

Throughout the following MD&A, all referenced amounts for the three and nine months ended September 30, 2007 reflect the balances and amounts on a restated basis.

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Executive Summary

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

Our current product lines are divided between the dermatological and non-dermatological fields. The dermatological field represents products for the treatment of acne and acne-related dermatological conditions and non-acne dermatological conditions. The non-dermatological field represents products for the treatment of urea cycle disorder and contract revenue. Our acne and acne-related dermatological product lines include DYNACIN®, PLEXION®, SOLODYN®, TRIAZ® and ZIANA®. Our non-acne dermatological product lines include LOPROX®, PERLANE®, RESTYLANE® and VANOS®. Our non-dermatological product lines include AMMONUL® and BUPHENYL®. Our non-dermatological field also includes contract revenues associated with licensing agreements and authorized generic agreements.

Key Aspects of Our Business

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

We have built our business by executing a four-part growth strategy: promoting existing brands, developing new products and important product line extensions, entering into strategic collaborations and acquiring complementary products, technologies and businesses. Our core philosophy is to cultivate high integrity relationships of trust and confidence with the foremost dermatologists and podiatrists and the leading plastic surgeons in the U.S. We rely on third parties to manufacture our products.

We estimate customer demand for our prescription products primarily through use of third party syndicated data sources which track prescriptions written by health care providers and dispensed by licensed pharmacies. The data represents extrapolations from information provided only by certain pharmacies and are estimates of historical demand levels. We estimate customer demand for our non-prescription products primarily through internal data that we compile. We observe trends from these data and, coupled with certain proprietary information, prepare demand forecasts that are the basis for purchase orders for finished and component inventory from our third party manufacturers and suppliers. Our forecasts may fail to accurately anticipate ultimate customer demand for our products. Overestimates of demand may result in excessive inventory production and underestimates may result in inadequate supply of our products in channels of distribution.

We schedule our inventory purchases to meet anticipated customer demand. As a result, miscalculation of customer demand or relatively small delays in our receipt of manufactured products could result in revenues being deferred or lost. Our operating expenses are based upon anticipated sales levels, and a high percentage of our operating expenses are relatively fixed in the short term.

We sell our products primarily to major wholesalers and retail pharmacy chains. Approximately 65%-75% of our gross revenues are typically derived from two major drug wholesale concerns. Depending on the customer, we recognize revenue at the time of shipment to the customer, or at the time of receipt by the customer, net of estimated provisions. Consequently, variations in the timing of revenue recognition could cause significant fluctuations in operating results from period to period and may result in unanticipated periodic earnings shortfalls or losses. We have recently entered into distribution services agreements with our two largest wholesale customers. We review the supply levels of our significant products sold to major wholesalers by reviewing periodic inventory reports that are supplied to us by our major wholesalers in accordance with the distribution services agreements. We rely wholly upon our wholesale and drug chain customers to effect the distribution allocation of substantially all of our products.

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We believe the trade inventory levels of our products, based on our review of the periodic inventory reports supplied by our major wholesalers and the estimated demand for our products based on prescription and other data, are reasonable. We further believe that inventories of our products among wholesale customers, taken as a whole, are similar to those of other specialty pharmaceutical companies, and that our trade practices, which periodically involve volume discounts and early payment discounts, are typical of the industry.

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

Purchases by any given customer, during any given period, may be above or below actual prescription volumes of any of our products during the same period, resulting in fluctuations of product inventory in the distribution channel.

Recent Developments

The following significant events and transactions occurred during the nine months ended September 30, 2008 and affected our results of operations, our cash flows and our financial condition:

Reduction in the carrying value of our investment in Revance

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

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

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During the three and nine month periods ended September 30, 2008, we reduced the carrying value of our investment in Revance and recorded a related charge to earnings of approximately $2.6 million and $5.5 million, respectively, as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of September 30, 2008.

Acceptance of RELOXIN® BLA by the FDA

On March 17, 2006, we entered into a development and distribution agreement with Ipsen Ltd., a wholly-owned subsidiary of Ipsen, S.A. (Ipsen), whereby Ipsen granted Aesthetica Ltd., our wholly-owned subsidiary, rights to develop, distribute and commercialize Ipsen s botulinum toxin type A product in the United States, Canada and Japan for aesthetic use by physicians. The product is commonly referred to as RELOXIN® in the U.S. aesthetic market and DYSPORT® in medical and aesthetic markets outside the U.S. The product is not currently approved for use in the U.S., Canada or Japan.

In May 2008, the FDA accepted the filing of Ipsen s Biologics License Application (BLA) for RELOXIN®, and in accordance with the agreement, we paid Ipsen $25.0 million during the three months ended June 30, 2008 upon achievement of this milestone. The $25.0 million was recognized as a charge to research and development expense in our condensed consolidated statement of operations during the three months ended June 30, 2008.

We will pay an additional $1.5 million upon the successful completion of a future regulatory milestone, $75.0 million upon the product s approval by the FDA and $2.0 million upon regulatory approval of the product in Japan.

Repurchase of New Notes

In accordance with the terms of our 1.5% Contingent Convertible Senior Notes Due 2033 (the New Notes), holders of the New Notes were able to require us to repurchase all or a portion of their New Notes on June 4, 2008, at 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash. Prior to June 4, 2008, approximately $283.9 million in principal amount of the New Notes was outstanding. Holders of approximately $283.7 million of New Notes elected to require us to repurchase their New Notes on June 4, 2008. We paid $283.7 million, plus accrued and unpaid interest of approximately $2.2 million, to the holders of New Notes that elected to require us to repurchase their New Notes. We also were required to pay an accumulated deferred tax liability of approximately $34.9 million related to the repurchased New Notes. Approximately $26.2 million of this $34.9 million deferred tax liability, which was included in income taxes payable in our condensed consolidated balance sheets as of June 30, 2008, was paid during the three months ended September 30, 2008. The remaining $8.7 million of this deferred tax liability will be paid during the three months ended December 31, 2008. Following the repurchase of these New Notes, $181,000 of principal amount of New Notes remained outstanding as of June 30, 2008 and September 30, 2008. We intend to redeem the remaining $181,000 of principal amount of New Notes during the fourth quarter of 2008 of during 2009, when practicable.

Acquisition of LipoSonix

On July 1, 2008, we, through our wholly-owned subsidiary Donatello, Inc., acquired LipoSonix, Inc. (LipoSonix), an independent, privately-held company that employs a staff of approximately 40 scientists, engineers and clinicians located near Seattle, Washington. LipoSonix is a medical device company developing non-invasive body sculpting technology, and recently launched its first product in Europe, where it is being marketed and sold through distributors. The LipoSonix technology is currently not approved for sale or use in the U.S.

Under terms of the transaction, we paid $150 million in cash for all of the outstanding shares of LipoSonix. In addition, we will pay LipoSonix stockholders certain milestone payments up to an additional $150 million upon FDA approval of the LipoSonix technology and if various commercial milestones are achieved on a worldwide basis.

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As part of the acquisition of LipoSonix, the estimated fair value of LipoSonix in-process research and development was determined to be $30.5 million. This $30.5 million amount was recognized as in-process research and development expense during the three months ended September 30, 2008.

The operating results of LipoSonix for the three months ended September 30, 2008 are included in our condensed consolidated statement of operations for the full quarterly period, as the acquisition closed on July 1, 2008. The operating results of LipoSonix are not included in our condensed consolidated statement of operations for any other periods.

Lease Exit Costs Related to Our Previous Headquarters Facility

In connection with occupancy of our new headquarter office, we ceased use of the prior headquarter office, which consists of approximately 75,000 square feet of office space, at an average annual expense of approximately $2.1 million, under an amended lease agreement that expires in December 2010. We have adopted SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, effective for exit or disposal activities initiated after December 31, 2002. Under SFAS 146, a liability for the costs associated with an exit or disposal activity is recognized when the liability is incurred. In accordance with SFAS 146, we recorded lease exit costs of approximately $4.8 million during the three months ended September 30, 2008 consisting of the initial liability of $4.7 million and accretion expense of $0.1 million. These amounts were recorded as selling, general and administrative expenses in our condensed consolidated statements of operations.

Results of Operations

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2008 (a)	**2007 (b) (Restated)**	**2008 (c)**	**2007 (d) (Restated)**
Net revenues	100.0%	100.0%	100.0%	100.0%
Gross profit (e)	90.6	83.3	91.8	86.0
Operating expenses	100.8	65.5	82.7	69.0
Operating (loss) income	(10.2)	17.8	9.1	17.0
Other expense	2.2		1.4	
Interest and investment (income) expense, net	(2.1)	(6.7)	(3.7)	(6.3)
(Loss) income before income tax expense	(10.3)	24.5	11.4	23.3
Income tax expense	2.4	9.2	6.5	8.7
Net (loss) income	(12.7)%	15.3%	4.9%	14.6%

(a) Included in operating expenses is $30.5 million (26.4% of net revenues) of acquired in-process research and development expense related to our acquisition of LipoSonix, $4.8 million (4.2% of net revenues) of lease exit costs related to our previous headquarters facility and $4.1 million (3.6% of net revenues) of compensation expense related to stock options and restricted stock.

(b) Included in operating expenses is $4.5 million (4.1% of net revenues) of compensation expense related to stock options and restricted stock and $2.2 million (1.9% of net revenues) of professional fees related to the strategic collaboration with Hyperion Therapeutics, Inc. (Hyperion).

(c) Included in operating expenses is $30.5 million (8.0% of net revenues) of acquired in-process research and development expense related to our acquisition of LipoSonix, $25.0 million (6.5% of net revenues) paid to Ipsen upon the FDA s acceptance of Ipsen s BLA for RELOXIN®, $13.2 million (3.5% of net revenues) of compensation expense related to stock options and restricted stock and $4.8 million (1.3% of net revenues) of lease exit costs related to our previous headquarters facility.

(d) Included in operating expenses is $15.7 million (4.9% of net revenues) of compensation expense related to stock options and restricted stock, $4.1 million (1.3% of net revenues) for the write-down of an intangible asset related to OMNICEF® and $2.2 million (0.7% of net revenues) of professional fees related to the strategic collaboration with Hyperion.

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

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Three Months Ended September 30, 2008 Compared to the Three Months Ended September 30, 2007

Net Revenues

The following table sets forth the net revenues for the three months ended September 30, 2008 (the third quarter of 2008) and the net revenues for the three months ended September 30, 2007 (the third quarter of 2007), along with the percentage of net revenues and percentage point change for each of our product categories (dollar amounts in millions):

	Third Quarter 2008	Third Quarter 2007 (Restated)	$ Change	% Change
Net product revenues	$ 110.6	$ 107.1	$ 3.5	3.3%
Net contract revenues	$ 4.8	$ 3.9	$ 0.9	24.7%
Net revenues	$ 115.4	$ 111.0	$ 4.4	4.0%

	Third Quarter 2008	Third Quarter 2007 (Restated)	$ Change	% Change
Acne and acne-related dermatological products	$ 66.3	$ 56.2	$ 10.1	18.0%
Non-acne dermatological products	34.1	43.8	(9.7)	(22.2)%
Non-dermatological products (including contract revenues)	15.0	11.0	4.0	36.6%
Total net revenues	$ 115.4	$ 111.0	$ 4.4	4.0%

	Third Quarter 2008	Third Quarter 2007 (Restated)	Percentage Point Change
Acne and acne-related dermatological products	57.4%	50.6%	6.8%
Non-acne dermatological products	29.6%	39.4%	(9.8)%
Non-dermatological products (including contract revenues)	13.0%	10.0%	3.0%
Total net revenues	100.0%	100.0%	

Net revenues associated with our acne and acne-related dermatological products increased by $10.1 million, or 18.0%, and by 6.8 percentage points as a percentage of net revenues during the third quarter of 2008 as compared to the third quarter of 2007 primarily as a result of the increased sales of TRIAZ® and DYNACIN®. Net revenues associated with our non-acne dermatological products decreased as a percentage of net revenues, and decreased in net dollars by 22.2% during the third quarter of 2008 as compared to the third quarter of 2007, primarily due to decreased sales of RESTYLANE® due to economic and competitive pressures in the marketplace. Net revenues associated with

our non-dermatological products increased by $4.0 million, or 36.6%, and by 3.0 percentage points as a percentage of net revenues during the third quarter of 2008 as compared to the third quarter of 2007, primarily due to an increase in sales of BUPHENYL® and an increase in contract revenue.

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The restatement had the following affect on the previously-reported net revenues for the third quarter of 2007:

	Third Quarter 2007 (in millions)
Net revenues, as previously reported	$ 120.4
Restatement adjustments:	
Sales return reserve adjustment	(10.8)
Other miscellaneous adjustments	1.4
Net revenues, as restated	$ 111.0

Gross Profit

Gross profit represents our net revenues less our cost of product revenue. Our cost of product revenue includes our acquisition cost for the products we purchase from our third party manufacturers and royalty payments made to third parties. Amortization of intangible assets related to products sold is not included in gross profit. Amortization expense related to these intangible assets for the third quarter of 2008 and 2007 was approximately $5.5 million and $5.7 million, respectively. Product mix plays a significant role in our quarterly and annual gross profit as a percentage of net revenues. Different products generate different gross profit margins, and the relative sales mix of higher gross profit products and lower gross profit products can affect our total gross profit.

The following table sets forth our gross profit for the third quarter of 2008 and 2007, along with the percentage of net revenues represented by such gross profit (dollar amounts in millions):

	Third Quarter 2008	Third Quarter 2007 (Restated)	$ Change	% Change
Gross profit	$104.6	$92.4	$12.2	13.2%
% of net revenues	90.6%	83.3%		

The increase in gross profit during the third quarter of 2008, compared to the third quarter of 2007, was due to the increase in our net revenues and the effect of an increase in our inventory valuation reserve of approximately $4.7 million during the third quarter of 2007, which decreased gross profit during the third quarter of 2007. The increase in our inventory valuation reserve during the third quarter of 2007 was primarily related to certain inventories that, during the third quarter of 2007, were determined to be unsalable. This increase in our inventory valuation reserve during the third quarter of 2007 decreased gross profit as a percentage of net revenues by approximately 4.2 percentage points. In addition, the amount of expense related to the cost of product donated to charitable organizations, which is a reduction of gross profit, decreased from $1.4 million during the third quarter of 2007 to $0.6 million during the third quarter of 2008.

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The restatement had the following effect on the previously-reported gross profit for the third quarter of 2007:

	Third Quarter 2007 (in millions)
Gross profit, as previously reported	$ 103.0
Restatement adjustments:	
Net revenue restatement adjustments	(9.4)
Reclassification of donated product from selling, general and administrative expense to cost of product revenues	(1.4)
Other	0.2
Gross profit, as restated	$ 92.4

Selling, General and Administrative Expenses

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

	Third Quarter 2008	Third Quarter 2007 (Restated)	$ Change	% Change
Selling, general and administrative	$71.6	$58.9	$12.7	21.6%
% of net revenues	62.0%	53.1%		
Share-based compensation expense included in selling, general and administrative	$ 4.0	$ 4.7	$ (0.7)	(15.3)%

The increase in selling, general and administrative expenses during the third quarter of 2008 from the third quarter of 2007 was attributable to approximately $3.6 million of increased personnel costs, primarily related to an increase in the number of employees from 465 as of September 30, 2007 to 577 as of September 30, 2008 and the effect of the annual salary increase that occurred during February 2008, $4.8 million related to a lease retirement obligation recorded during the third quarter of 2008 related to our prior headquarters location, $4.0 million of increased professional and consulting expenses, including costs related to patent litigation associated with our SOLODYN® product, business development costs and the implementation of our new enterprise resource planning (ERP) system, and $0.3 million of increased other additional selling, general and administrative costs incurred during the third quarter of 2008. We expect to continue to incur legal and other professional fees during the fourth quarter of 2008 as a result of patent protection related to our SOLODYN® and VANOS® products and the recent purported stockholder class action lawsuits styled Andrew Hall v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01821-MHB); Steamfitters Local 449 Pension Fund v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01870-DKD); and Darlene Oliver v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01964-JAT).

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The restatement had the following effect on the previously-reported selling, general and administrative expense for the third quarter of 2007:

	Third Quarter 2007 (in millions)
Selling, general and administrative expense, as previously reported	$ 60.3
Restatement adjustment:	
Reclassification of donated product from selling, general and administrative expense to cost of product revenues	(1.4)
Selling, general and administrative expense, as restated	$ 58.9

Research and Development Expenses

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

	Third Quarter 2008	Third Quarter 2007	$ Change	% Change
Research and development	$7.1	$ 7.4	$(0.3)	(2.9)%
Share-based compensation expense included in research and development	$0.1	$(0.2)	$ 0.3	151.5%

We expect research and development expenses to continue to fluctuate from quarter to quarter based on the timing of the achievement of development milestones under license and development agreements, as well as the timing of other development projects and the funds available to support these projects.

In accordance with our development and distribution agreement with Ipsen for the development of RELOXIN®, we will pay Ipsen $1.5 million upon successful completion of a future regulatory milestone, and $75.0 million upon the FDA s approval of RELOXIN®.

In-Process Research and Development Expense

On July 1, 2008, we acquired LipoSonix, a medical device company developing non-invasive body sculpting technology. As part of the acquisition, we recorded a $30.5 million charge for acquired in-process research and development during the third quarter of 2008. No income tax benefit was recognized related to this charge. See Note 6 in our accompanying condensed consolidated financial statements for further discussion on our acquisition of LipoSonix.

Depreciation and Amortization Expenses

Depreciation and amortization expenses during the third quarter of 2008 increased $0.6 million, or 9.5%, to $7.1 million from $6.5 million during the third quarter of 2007. This increase was primarily due to depreciation incurred in the third quarter of 2008 related to our new ERP system and our new headquarters facility.

Other Expense

Other expense of $2.6 million recognized during the third quarter of 2008 represented a reduction in the carrying value of our investment in Revance as a result of a reduction in the estimated net realizable

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value of the investment using the hypothetical liquidation at book value approach as of September 30, 2008.

Interest and Investment Income

Interest and investment income during the third quarter of 2008 decreased $6.4 million, or 65.1%, to $3.4 million from $9.8 million during the third quarter of 2007, due to an decrease in the funds available for investment due to the repurchase of $283.7 million of our New Notes in June 2008 and our $150.0 million acquisition of LipoSonix in July 2008, and a decrease in the interest rates achieved by our invested funds during the third quarter of 2008. We expect interest and investment income to be lower in the fourth quarter of 2008 as compared to the fourth quarter of 2007 due to the decrease in funds available for investment due to the repurchase of $283.7 million of our New Notes in June 2008 and the $150.0 million acquisition of LipoSonix in July 2008. See Note 13 in our accompanying condensed consolidated financial statements for further discussion on the New Notes.

Interest Expense

Interest expense during the third quarter of 2008 decreased $1.3 million, to $1.1 million during the third quarter of 2008 from $2.4 million during the third quarter of 2007. Our interest expense during the third quarter of 2008 consisted of interest expense on our Old Notes, which accrue interest at 2.5% per annum and our New Notes, which accrue interest at 1.5% per annum. Our interest expense during the third quarter of 2007 consisted of interest expense on our Old Notes, our New Notes, and amortization of fees and other origination costs related to the issuance of the New Notes. The decrease in interest expense during the third quarter of 2008 as compared to the third quarter of 2007 was primarily due to the repurchase of $283.7 million of our New Notes in June 2008, and due to the fees and origination costs related to the issuance of the New Notes becoming fully amortized during the second quarter of 2008. See Note 13 in our accompanying condensed consolidated financial statements for further discussion on the Old Notes and New Notes. We expect interest expense to be lower in the fourth quarter of 2008 as compared to the fourth quarter of 2007 due to the impact of the repurchase of $283.7 million of our New Notes in June 2008 and the impact of the origination costs of the New Notes being fully amortized as of June 30, 2008. The tax-effected net interest expense and issue cost amortization on the Old Notes and New Notes are added back to net income when computing diluted net income per share.

Income Tax Expense

Our effective tax rate for the third quarter of 2008 was (22.8)%, as compared to 37.4% for the third quarter of 2007. The provision for income taxes generally reflects management s estimate of the effective tax rate expected to be applicable for the full fiscal year. We recorded a tax provision in spite of the pre-tax loss for the third quarter of 2008 as no tax benefits were recorded related to the charge associated with the reduction in carrying value of our investment in Revance or on the in-process research and development charge related to our acquisition of LipoSonix.

The effect of the restatement on income tax expense for the third quarter of 2007 was a decrease of $3.4 million, due to a decrease of $9.2 million of pre-tax income as a result of the restatement. The effect of the restatement on the effective tax rate for the third quarter of 2007 was an increase from 37.3% to 37.4%.

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Nine Months Ended September 30, 2008 Compared to the Nine Months Ended September 30, 2007

Net Revenues

The following table sets forth our net revenues for the nine months ended September 30, 2008 (the 2008 nine months) and the nine months ended September 30, 2007 (the 2007 nine months), along with the percentage of net revenues and percentage point change for each of our product categories (dollar amounts in millions):

	2008 Nine Months	2007 Nine Months (Restated)	$ Change	% Change
Net product revenues	$ 368.7	$ 313.7	$ 55.0	17.5%
Net contract revenues	$ 13.1	$ 9.6	$ 3.5	36.6%
Net revenues	$ 381.8	$ 323.3	$ 58.5	18.1%

	2008 Nine Months	2007 Nine Months (Restated)	$ Change	% Change
Acne and acne-related dermatological products	$ 232.8	$ 166.0	$ 66.8	40.2%
Non-acne dermatological products	113.7	130.1	(16.4)	(12.6)%
Non-dermatological products (including contract revenues)	35.3	27.2	8.1	29.9%
Total net revenues	$ 381.8	$ 323.3	$ 58.5	18.1%

	2008 Nine Months	2007 Nine Months (Restated)	Percentage Point Change
Acne and acne-related dermatological products	61.0%	51.4%	9.6%
Non-acne dermatological products	29.8%	40.2%	(10.4)%
Non-dermatological products (including contract revenues)	9.2%	8.4%	0.8%
Total net revenues	100.0%	100.0%	

Our total net revenues increased during the 2008 nine months primarily as a result of an increase in sales of SOLODYN®. Net revenues associated with our acne and acne-related dermatological products increased by $66.8 million, or 40.2%, and by 9.6 percentage points as a percentage of net revenues during the 2008 nine months as compared to the 2007 nine months primarily as a result of the increased sales of SOLODYN®. Net revenues associated with our non-acne dermatological products decreased as a percentage of net revenues, and decreased in net dollars by 12.6% during the 2008 nine months as compared to the 2007 nine months, primarily due to decreased sales of RESTYLANE® due to economic and competitive pressures in the marketplace. Net revenues associated with our

non-dermatological products increased by $8.1 million, or 29.9%, and by 0.8 percentage points as a percentage of net revenues during the 2008 nine months as compared to the 2007 nine months, primarily due to an increase in sales of BUPHENYL® and AMMONUL® and an increase in contract revenue.

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The restatement had the following effect on the previously-reported net revenues for the 2007 nine months:

	2007 Nine Months (in millions)
Net revenues, as previously reported	$ 324.4
Restatement adjustments:	
Sales return reserve adjustment	(1.9)
Other miscellaneous adjustments	0.8
Net revenues, as restated	$ 323.3

Gross Profit

Gross profit represents our net revenues less our cost of product revenue. Our cost of product revenue includes our acquisition cost for the products we purchase from our third party manufacturers and royalty payments made to third parties. Amortization of intangible assets related to products sold is not included in gross profit. Amortization expense related to these intangible assets for the 2008 nine months and 2007 nine months was approximately $16.0 million and $15.2 million, respectively. Product mix plays a significant role in our quarterly and annual gross profit as a percentage of net revenues. Different products generate different gross profit margins, and the relative sales mix of higher gross profit products and lower gross profit products can affect our total gross profit.

The following table sets forth our gross profit for the 2008 nine months and the 2007 nine months, along with the percentage of net revenues represented by such gross profit (dollar amounts in millions):

	2008 Nine Months	2007 Nine Months (Restated)	$ Change	% Change
Gross profit	$350.6	$277.8	$72.8	26.2%
% of net revenues	91.8%	86.0%		

The increase in gross profit during the 2008 nine months, compared to the 2007 nine months, was due to the increase in our net revenues and the increase in gross profit as a percentage of net revenues was primarily due to the different mix of high gross margin products sold during the 2008 nine months as compared to the 2007 nine months. Increased sales of SOLODYN®, a higher margin product, during the 2008 six months, was the primary change in the mix of products sold during the comparable periods that affected gross profit as a percentage of net revenues. In addition, gross margin for the 2007 nine months included a charge for an increase in our inventory obsolescence reserve of approximately $8.3 million, which reduced gross margin as a percentage of net revenues by approximately 2.6 percentage points. The increase in the inventory obsolescence reserve during the 2007 nine months was due to an increase in inventory during the 2007 nine months projected to not be sold by expiry dates, and certain inventories that, during the third quarter of 2007, were determined to be unsalable.

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The restatement had the following effect on the previously-reported gross profit for the 2007 nine months:

	2007 Nine Months (in millions)
Gross profit, as previously reported	$ 282.4
Restatement adjustments:	
Net revenue restatement adjustments	(1.1)
Reclassification of donated product from selling, general and administrative expense to cost of product revenues	(3.7)
Other	0.2
Gross profit, as restated	$ 277.8

Selling, General and Administrative Expenses

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

	2008 Nine Months	2007 Nine Months (Restated)	$ Change	% Change
Selling, general and administrative	$215.5	$178.7	$36.8	20.6%
% of net revenues	56.4%	55.3%		
Share-based compensation expense included in selling, general and administrative	$ 12.9	$ 15.6	$ (2.7)	(17.2)%

The increase in selling, general and administrative expenses during the 2008 nine months from the 2007 nine months was attributable to approximately $13.7 million of increased personnel costs, primarily related to an increase in the number of employees from 465 as of September 30, 2007 to 577 as of September 30, 2008 and the effect of the annual salary increase that occurred during February 2008, $15.6 million of increased professional and consulting expenses, including costs related to patent litigation associated with our SOLODYN® product, business development costs and the implementation of our new enterprise resource planning (ERP) system, $4.8 million related to a lease retirement obligation recorded during the third quarter of 2008 related to our prior headquarters location, and $2.7 million of increased other additional selling, general and administrative costs incurred during the 2008 nine months.

The restatement had the following effect on the previously-reported selling, general and administrative expense for the 2007 nine months:

	2007 Nine Months (in millions)
Selling, general and administrative expense, as previously reported	$ 182.4
Restatement adjustment:	
Reclassification of donated product from selling, general and administrative expense to cost of product revenues	(3.7)
Selling, general and administrative expense, as restated	$ 178.7

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Impairment of Long-lived Assets

During the second quarter of 2007, a long-lived asset related to OMNICEF® was determined to be impaired based on our analysis of the long-lived asset s carrying value and projected future cash flows. As a result of the impairment analysis, we recorded a write-down of approximately $4.1 million related to this long-lived asset.

Factors affecting the future cash flows of the OMNICEF® long-lived asset included an early termination letter received during May 2007 from Abbott, which transitions our co-promotion agreement with Abbott into a two-year residual period, and competitive pressures in the marketplace, including generic competition.

Research and Development Expenses

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

	2008 Nine Months	2007 Nine Months	$ Change	% Change
Research and development	$49.3	$22.5	$26.8	119.2%
Charges included in research and development	$25.0	$	$25.0	100.0%
Share-based compensation expense included in research and development	$ 0.2	$ 0.0	$ 0.2	453.2%

Included in research and development expenses for the 2008 nine months was a $25.0 million milestone payment made to Ipsen after the FDA s May 19, 2008 acceptance of the filing of Ipsen s BLA for RELOXIN®. The primary product under development during the 2008 nine months and the 2007 nine months was RELOXIN®.

In-Process Research and Development Expense

On July 1, 2008, we acquired LipoSonix, a medical device company developing non-invasive body sculpting technology. As part of the acquisition, we recorded a $30.5 million charge for acquired in-process research and development during the third quarter of 2008. No income tax benefit was recognized related to this charge. See Note 6 in our accompanying condensed consolidated financial statements for further discussion on our acquisition of LipoSonix.

Depreciation and Amortization Expenses

Depreciation and amortization expenses during the 2008 nine months increased $2.8 million, or 15.7%, to $20.6 million from $17.8 million during the 2007 nine months. This increase was primarily due to amortization related to a $29.1 million milestone payment made to Q-Med related to the FDA approval of PERLANE® capitalized during the second quarter of 2007 and depreciation incurred in the 2008 nine months related to our new ERP system and our new headquarters facility.

Other Expense

Other expense of $5.5 million recognized during the 2008 nine months represented a $2.9 million and $2.6 million reduction in the carrying value of our investment in Revance as a result of a reduction in the estimated net realizable value of the investment using the hypothetical liquidation at book value approach as of March 31, 2008 and September 30, 2008, respectively.

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Interest and Investment Income

Interest and investment income during the 2008 nine months decreased $8.0 million, or 28.5%, to $20.1 million from $28.1 million during the 2007 nine months, due to an decrease in the funds available for investment due to the repurchase of $283.7 million of our New Notes in June 2008 and our $150.0 million acquisition of LipoSonix in July 2008, and a decrease in the interest rates achieved by our invested funds during the 2008 nine months. We expect interest and investment income to be lower in the fourth quarter of 2008 as compared to the fourth quarter of 2007 due to the decrease in funds available for investment due to the repurchase of $283.7 million of our New Notes in June 2008 and our $150 million acquisition of LipoSonix in July 2008. See Note 13 in our accompanying condensed consolidated financial statements for further discussion on the New Notes.

Interest Expense

Interest expense during the 2008 nine months decreased $2.0 million, to $5.6 million during the 2008 nine months from $7.6 million during the 2007 nine months. Our interest expense during the 2008 nine months and 2007 nine months consisted of interest expense on our Old Notes, which accrue interest at 2.5% per annum, our New Notes, which accrue interest at 1.5% per annum, and amortization of fees and other origination costs related to the issuance of the Old Notes and New Notes. The decrease in interest expense during the 2008 nine months as compared to the 2007 nine months was primarily due to the repurchase of $283.7 million of our New Notes in June 2008, the fees and origination costs related to the issuance of the Old Notes becoming fully amortized during the second quarter of 2007, and the fees and origination costs related to the issuance of the New Notes becoming fully amortized during the second quarter of 2008. See Note 13 in our accompanying condensed consolidated financial statements for further discussion on the Old Notes and New Notes. We expect interest expense to be lower in the fourth quarter of 2008 as compared to the fourth quarter 2007 due to the impact of the repurchase of $283.7 million of our New Notes in June 2008 and the impact of the origination costs of the New Notes being fully amortized as of June 30, 2008. The tax-effected net interest expense and issue cost amortization on the Old Notes and New Notes are added back to net income when computing diluted net income per share.

Income Tax Expense

Our effective tax rate for the 2008 nine months was 56.8%, as compared to 37.2% for the 2007 nine months. The provision for income taxes generally reflects management s estimate of the effective tax rate expected to be applicable for the full fiscal year. Our effective rate was higher during the 2008 nine months as compared to the 2007 nine months as no tax benefits were recorded related to the charge associated with the reduction in carrying value of our investment in Revance or on the in-process research and development charge related to our acquisition of LipoSonix.

The effect of the restatement on income tax expense for the 2007 nine months was a decrease of $0.5 million, due to a decrease of $0.9 million of pre-tax income as a result of the restatement. The effect of the restatement on the effective tax rate for the 2007 nine months was a decrease from 37.5% to 37.2%.

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Liquidity and Capital Resources

Overview

The following table highlights selected cash flow components for the 2008 nine months and 2007 nine months, and selected balance sheet components as of September 30, 2008 and December 31, 2007 (dollar amounts in millions):

	2008 Nine Months	2007 Nine Months	$ Change	% Change
Cash provided by (used in):				
Operating activities	$ 40.7	$ 127.5	$ (86.8)	(68.1)%
Investing activities	$ 195.3	$(261.3)	$ 456.6	174.7%
Financing activities	$(285.0)	$ 13.3	$(298.4)	(2,235.1)%

	Sept. 30, 2008	Dec. 31, 2007	$ Change	% Change
Cash, cash equivalents and short-term investments	$ 307.1	$ 794.7	$(487.6)	(61.4)%
Working capital	$ 267.2	$ 423.0	$(155.8)	(36.8)%
Long-term investments	$ 93.4	$ 17.1	$ 76.3	446.2%
2.5% contingent convertible senior notes due 2032	$ 169.2	$ 169.2	$	
1.5% contingent convertible senior notes due 2033	$ 0.2	$ 283.9	$(283.7)	(99.9)%

Working Capital

Working capital as of September 30, 2008 and December 31, 2007 consisted of the following (dollar amounts in millions):

	Sept. 30, 2008	Dec. 31, 2007	$ Change	% Change
Cash, cash equivalents and short-term investments	$ 307.1	$ 794.7	$ (487.6)	(61.4)%
Accounts receivable, net	48.0	22.2	25.8	116.2%
Inventories, net	25.4	30.0	(4.6)	(15.3)%
Deferred tax assets, net	45.0	9.2	35.8	389.1%
Other current assets	21.1	18.0	3.1	17.2%
Total current assets	446.6	874.1	(427.5)	(48.9)%
Accounts payable	48.2	34.9	13.3	38.1%
Current portion of long- term debt	0.2	283.9	(283.7)	(99.9)%
Reserve for sales returns	59.3	68.8	(9.5)	(13.8)%
Income taxes payable		7.7	(7.7)	100.0%
Other current liabilities	71.7	55.8	15.9	28.5%
Total current liabilities	179.4	451.1	(271.7)	(60.2)%
Working capital	$ 267.2	$ 423.0	$ (155.8)	(36.8)%

We had cash, cash equivalents and short-term investments of $307.1 million and working capital of $267.2 million at September 30, 2008, as compared to $794.7 million and $423.0 million, respectively, at December 31, 2007. The decrease in cash, cash equivalents and short-term investments was primarily due to the repurchase of $283.7 million of our New Notes during June 2008, the $150.0 million acquisition of LipoSonix, and by a net transfer of $76.3 million of our short-term investments into long-term investments, partially offset by the generation of $42.7 million of operating cash flow during the 2008 nine months. The decrease in working capital was primarily due to the $150.0 million acquisition of LipoSonix and a net transfer of $76.3 million of our short-term investments into long-term investments, partially offset by the generation of $40.7 million of operating cash flow during the 2008 nine months.

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Management believes existing cash and short-term investments, together with funds generated from operations, should be sufficient to meet operating requirements for the foreseeable future. Our cash and short-term investments are available for dividends, strategic investments, acquisitions of companies or products complementary to our business, the repayment of outstanding indebtedness, repurchases of our outstanding securities and other potential large-scale needs. In addition, we may consider incurring additional indebtedness and issuing additional debt or equity securities in the future to fund potential acquisitions or investments, to refinance existing debt or for general corporate purposes. If a material acquisition or investment is completed, our operating results and financial condition could change materially in future periods. However, no assurance can be given that additional funds will be available on satisfactory terms, or at all, to fund such activities.

On July 1, 2008, we acquired LipoSonix, an independent, privately-held company that employs a staff of approximately 40 scientists, engineers and clinicians located near Seattle, Washington. LipoSonix is a medical device company developing non-invasive body sculpting technology, and recently launched its first product in Europe, where it is being marketed and sold through distributors. The LipoSonix technology is currently not approved for sale or use in the United States. Under terms of the transaction, we paid $150 million in cash for all of the outstanding shares of LipoSonix. In addition, we will pay LipoSonix stockholders certain milestone payments up to an additional $150 million upon FDA approval of the LipoSonix technology and if various commercial milestones are achieved on a worldwide basis.

As of September 30, 2008, our short-term investments included $39.9 million of auction rate floating securities. Our auction rate floating securities are debt instruments with a long-term maturity and with an interest rate that is reset in short intervals through auctions. The recent negative conditions in the credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. As a result, these affected auction rate floating securities are now considered illiquid, and we could be required to hold them until they are redeemed by the holder at maturity. We may not be able to make the securities liquid until a future auction on these investments is successful. As a result of the lack of liquidity of these investments, at September 30, 2008, we have recorded an unrealized loss of $4.8 million on our auction rate floating securities in accumulated other comprehensive income in our condensed consolidated balance sheets.

During July 2006, we executed a lease agreement for new headquarter office space to accommodate our expected long-term growth. The first phase is for approximately 150,000 square feet with the right to expand. We occupied the new headquarter office space, which is located approximately one mile from our previous headquarter office space in Scottsdale, Arizona, during the second quarter of 2008. There is no cash obligation for lease payments until 2009. We obtained possession of the leased premises and therefore began accruing rent expense during the first quarter of 2008. Rent expense recognized during the 2008 nine months related to this property was approximately $2.2 million. During the first quarter of 2008, we received approximately $6.7 million in tenant improvement incentives from the landlord. This amount has been capitalized into leasehold improvements and is being depreciated on a straight-line basis over the lesser of the useful life or the term of the lease. The tenant improvement incentives are also included in other long-term liabilities as deferred rent, and will be recognized as a reduction of rent expense on a straight-line basis over the term of the lease. In 2008, upon vacating our previous headquarters facility, we recorded a charge for the estimated remaining net cost for the lease, net of potential sublease income, of $4.8 million. See *Contingent Convertible Senior Notes and Other Long-Term Commitments*.

During 2007, we began designing and implementing a new enterprise resource planning (ERP) system to integrate and improve the financial and operational aspects of our business. During 2007 and the nine months ended September 30, 2008, we invested approximately $9.5 million and $4.0 million, respectively, on this project.

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Operating Activities

Net cash provided by operating activities during the 2008 nine months was approximately $40.7 million, compared to net cash provided by operating activities during the 2007 nine months of approximately $127.5 million. The following is a summary of the primary components of cash provided by operating activities during the 2008 nine months and 2007 nine months (in millions):

	2008 Nine Months	2007 Nine Months
Payments made to Ipsen related to development of RELOXIN®	$ (25.0)	$
Income taxes paid	(67.1)	(19.7)
Payment received from Hyperion related to strategic collaboration		10.0
Other cash provided by operating activities	132.8	137.2
Cash provided by operating activities	$ 40.7	$ 127.5

Investing Activities

Net cash provided by investing activities during the 2008 nine months was approximately $195.3 million, compared to net cash used in investing activities during the 2007 nine months of $261.3 million. The change was primarily due to the net purchases and sales of our short-term and long-term investments during the respective nine-month periods. During the 2008 nine months, $150.0 million was used for the acquisition of LipoSonix and during the 2007 nine months, $29.1 million was paid to Q-Med upon the FDA s approval of PERLANE®.

Financing Activities

Net cash used in financing activities during the 2008 nine months was $285.0 million, compared to net cash provided by financing activities of $13.3 million during the 2007 nine months. Cash used in financing activities during the 2008 nine months included the repurchase of $283.7 million of New Notes during June 2008. Proceeds from the exercise of stock options were $4.8 million during the 2008 nine months compared to $17.1 million during the 2007 nine months. Dividends paid during the 2008 nine months was $6.3 million, and dividends paid during the 2007 nine months was $5.1 million.

Contingent Convertible Senior Notes and Other Long-Term Commitments

We have two outstanding series of Contingent Convertible Senior Notes, consisting of $169.2 million principal amount of 2.5% Contingent Convertible Senior Notes due 2032 (the Old Notes) and $0.2 million principal amount of 1.5% Contingent Convertible Senior Notes due 2033 (the New Notes). In accordance with the terms of our New Notes, holders of the New Notes were able to require us to repurchase all or a portion of their New Notes on June 4, 2008, at 100% of the principal amount of the New Notes, plus accrued and unpaid interest, including contingent interest, if any, to the date of the repurchase, payable in cash. Prior to June 4, 2008, approximately $283.9 million in principal amount of the New Notes was outstanding. Holders of approximately $283.7 million of New Notes elected to require us to repurchase their New Notes on June 4, 2008. We paid $283.7 million, plus accrued and unpaid interest of approximately $2.2 million, to the holders of New Notes that elected to require us to repurchase their New Notes. We also were required to pay an accumulated deferred tax liability of approximately $34.9 million related to the repurchased New Notes. Approximately $26.2 million of this $34.9 million deferred tax liability, which was included in income taxes payable in our condensed consolidated balance sheets as of June 30, 2008, was paid during the three months ended September 30, 2008. The remaining $8.7 million of this deferred tax liability will be paid during the three months ended December 31, 2008. Following the repurchase of these New Notes, $181,000 of principal amount of New Notes remained outstanding as of June 30, 2008 and September 30, 2008. We intend to redeem the remaining $181,000 of principal amount of New Notes during the fourth quarter of 2008 or during 2009, when practicable.

The New Notes and the Old Notes are unsecured and do not contain any restrictions on the incurrence of additional indebtedness or the repurchase of our securities, and do not contain any financial covenants. The Old Notes do not contain any restrictions on the payment of dividends. The New Notes

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require an adjustment to the conversion price if the cumulative aggregate of all current and prior dividend increases above $0.025 per share would result in at least a one percent (1%) increase in the conversion price. This threshold has not been reached and no adjustment to the conversion price has been made. On June 4, 2012 and 2017 or upon the occurrence of a change in control, holders of the Old Notes may require us to offer to repurchase their Old Notes for cash. On June 4, 2013 and 2018 or upon the occurrence of a change in control, holders of the New Notes may require us to offer to repurchase their New Notes for cash.

Except for the Old Notes, we had only $15.7 million of long-term liabilities and we had only $179.4 million of current liabilities at September 30, 2008. Our other commitments and planned expenditures consist principally of payments we will make in connection with strategic collaborations and research and development expenditures, and we will continue to invest in sales and marketing infrastructure. In addition, we will be continuing our implementation of a new ERP system during 2008, which will require financial expenditures to complete.

We have made available to BioMarin Pharmaceutical Inc. (BioMarin) the ability to draw down on a Convertible Note up to $25.0 million beginning July 1, 2005 (the Convertible Note). The Convertible Note is convertible based on certain terms and conditions including a change of control provision. Money advanced under the Convertible Note is convertible into BioMarin shares at a strike price equal to the BioMarin average closing price for the 20 trading days prior to such advance. The Convertible Note matures on the option purchase date in 2009 as defined in the securities purchase agreement entered into on May 18, 2004, but may be repaid by BioMarin at any time prior to the option purchase date. As of November 10, 2008, BioMarin has not requested any monies to be advanced under the Convertible Note, and no amounts are outstanding.

In connection with occupancy of the new headquarter office, we ceased use of the prior headquarter office, which consists of approximately 75,000 square feet of office space, at an average annual expense of approximately $2.1 million, under an amended lease agreement that expires in December 2010. We have adopted SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, effective for exit or disposal activities initiated after December 31, 2002. Under SFAS 146, a liability for the costs associated with an exit or disposal activity is recognized when the liability is incurred. In accordance with SFAS 146, we recorded lease exit costs of approximately $4.8 million during the three months ended September 30, 2008 consisting of the initial liability of $4.7 million and accretion expense of $0.1 million. These amounts were recorded as selling, general and administrative expenses in our condensed consolidated statements of operations. We have not recorded any other costs related to the lease for the prior headquarters.

As of September 30, 2008, approximately $4.5 million of lease exit costs remain accrued and are expected to be paid by December 2010 of which $1.9 million is classified in other current liabilities and $2.6 million is classified in other liabilities. Although we no longer use the facilities, the lease exit cost accrual has not been offset by an adjustment for estimated sublease rentals. After considering sublease market information as well as factors specific to the lease, we concluded it was probable we would be unable to reasonably obtain sublease rentals for the prior headquarters and therefore we would not be subleased for the remaining lease term. We will continue to monitor the sublease market conditions and reassess the impact on the lease exit cost accrual.

The following is a summary of the activity in the liability for lease exit costs for the three months ended September 30, 2008:

	Liability as of June 30, 2008	Amounts Charged to Expense	Cash Payments Made	Cash Received from Sublease	Liability as of Sept. 30, 2008
Lease exit costs liability	$	$ 4,812,928	$ (356,352)	$	$ 4,456,576

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Repurchases of Common Stock

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

Dividends

We do not have a dividend policy. Since July 2003, we have paid quarterly cash dividends aggregating approximately $34.8 million on our common stock. In addition, on September 17, 2008, we declared a cash dividend of $0.04 per issued and outstanding share of common stock payable on October 31, 2008 to our stockholders of record at the close of business on October 1, 2008. Prior to these dividends, we had not paid a cash dividend on our common stock. Any future determinations to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon our financial condition, operating results, capital requirements and other factors that our Board of Directors deems relevant.

Fair Value Measurements

As discussed in Note 5 to the unaudited condensed consolidated financial statements, we adopted the provisions of SFAS No. 157 as of January 1, 2008. We determined that we utilize unobservable (Level 3) inputs in determining the fair value of our auction rate floating security investments, which totaled $39.9 million at September 30, 2008. These securities were included in long-term investments at September 30, 2008.

Our auction rate floating securities are classified as available for sale securities and are reflected at fair value. In prior periods, due to the auction process which took place every 30-35 days for most securities, quoted market prices were readily available, which would qualify as Level 1 under SFAS No. 157. However, due to events in credit markets during the first quarter of 2008, the auction events for most of these instruments failed, and, therefore, we determined the estimated fair values of these securities utilizing a discounted cash flow analysis or other type of valuation model as of September 30, 2008. These analyses consider, among other items, the collateralization underlying the security investments, the expected future cash flows, including the final maturity, associated with the securities, and the expectation of the next time the security is expected to have a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics to the securities held by us. Due to these events, we reclassified these instruments as Level 3 during the first quarter of 2008 and have recorded a temporary unrealized decline in fair value of $4.8 million, with an offsetting entry to accumulated other comprehensive (loss) income, as of September 30, 2008. We currently believe that this temporary decline in fair value is due entirely to liquidity issues, because the underlying assets for the majority of securities are almost entirely backed by the U.S. government. In addition, our holdings of auction rate floating securities represented less than ten percent of our total cash and cash equivalents, restricted cash and short-term and long-term investment balance at September 30, 2008, which we believe allows us sufficient time for the securities to return to full value. Because we believe that the current decline in fair value is temporary and based only on liquidity issues in the credit markets, any difference between our estimate and an estimate that would be arrived at by another party would have no impact on our earnings, since such difference would also be recorded to accumulated other comprehensive (loss) income. We will re-evaluate each of these factors as market conditions change in subsequent periods.

Off-Balance Sheet Arrangements

As of September 30, 2008, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Securities and Exchange Commission (SEC) Regulation S-K.

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Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. The preparation of the condensed consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates related to sales allowances, chargebacks, rebates, returns and other pricing adjustments, depreciation and amortization and other contingencies and litigation. We base our estimates on historical experience and various other factors related to each circumstance. Actual results could differ from those estimates based upon future events, which could include, among other risks, changes in the regulations governing the manner in which we sell our products, changes in the health care environment and managed care consumption patterns. Our significant accounting policies are described in Note 3 to the consolidated financial statements included in our Form 10-K/A for the year ended December 31, 2007. There were no new significant accounting estimates in the third quarter of 2008, nor were there any material changes to the critical accounting policies and estimates discussed in our Form 10-K/A for the year ended December 31, 2007.

Recent Accounting Pronouncements

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

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

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, which replaces SFAS No. 141 and establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any controlling interest. It also established principles and requirements for how an acquirer in a business combination recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R provides for the following changes from SFAS No. 141: 1) an acquirer will record all assets and liabilities of acquired business, including goodwill, at fair value, regardless of the level of interest acquired; 2) certain contingent assets and liabilities acquired will be recognized at fair value at the acquisition date; 3) contingent consideration will be recognized at fair value on the acquisition date with changes in fair value to be recognized in earnings upon settlement; 4) acquisition-related transaction and restructuring costs will be expensed as incurred rather than treated as part of the cost of the acquisition and included in the amount recorded for assets acquired; 5) reversals of valuation allowances related to acquired deferred tax assets

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and changes to acquired income tax uncertainties will be recognized in earnings; and 6) when making adjustments to finalize initial accounting, acquirers will revise any previously issued post-acquisition financial information in future financial statements to reflect any adjustments as if they occurred on the acquisition date. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating SFAS No. 141R and its impact, if any, on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51*. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest, or minority interest, as equity in the consolidated financial statements and separate from the parent s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the statement of operations. SFAS No. 160 clarifies that changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains it controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We are currently evaluating SFAS No. 160 and its impact, if any, on our consolidated results of operations and financial condition.

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

In April 2008, the FASB issued FSP 142-3, *Determination of the Useful Life of Intangible Assets*. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating FSP 142-3 and its impact, if any, on our consolidated results of operations and financial condition.

In May 2008, the FASB issued FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. FSP APB 14-1 clarifies the accounting for convertible debt instruments that may be settled in cash (including partial cash settlement) upon conversion. FSP APB 14-1 specifies that issuers of such instruments should separately account for the liability and equity components of certain convertible debt instruments in a manner that reflects the issuer s nonconvertible debt borrowing rate when interest cost is recognized. FSP APB 14-1 requires bifurcation of a component of the debt, classification of that component in equity and the accretion of the resulting discount on the debt to be recognized as part of interest expense. FSP APB 14-1 requires retrospective application to the terms of instruments as they existed for all periods presented. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008, and early adoption is not permitted. We do not expect FSP APB 14-1 to impact our consolidated results of operations and financial condition.

In June 2008, the FASB reached a consensus on EITF 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock.* EITF 07-5 addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity s own stock. EITF 07-5 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating EITF 07-5 and the impact, if any, on our consolidated results of operations and

financial condition.

In October 2008, the FASB issued FSP 157-3*, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active.* FSP 157-3 clarifies the application of SFAS No. 157, *Fair*

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Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining fair value of financial assets when the market for that financial asset is not active. FSP 157-3 applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with SFAS No. 157. FSP 157-3 was effective upon issuance and included prior periods for which financial statements had not been issued. The application of FSP 157-3 did not have a material impact on our consolidated financial statements.

Forward-Looking Statements

This Quarterly Report on Form 10-Q and other documents we file with the SEC include forward-looking statements. These include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales and marketing efforts, expenses, the outcome of contingencies, such as legal proceedings, and financial results. From time to time, we also may make forward-looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls, and conference calls. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements are based on certain assumptions made by us based on our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward-looking statements. Such statements are subject to a number of assumptions, risks and uncertainties, many of which are beyond our control. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as anticipate, estimate, expect, project, intend, plan, believe, will, should, outlook, could, target, and other w similar meaning in connection with any discussion of future operations or financial performance. Among the factors that could cause actual results to differ materially from our forward-looking statements are the following:

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

- increases or decreases in the expected costs to be incurred in connection with the research and development, clinical trials, regulatory approvals, commercialization and marketing of our products;

- the success of research and development activities, including the development of RELOXIN® and additional forms of SOLODYN®, and our ability to obtain regulatory approvals;

- the speed with which regulatory authorizations and product launches may be achieved;

- changes in the FDA s position on the safety or effectiveness of our products;

- changes in our product mix;

- the anticipated size of the markets and demand for our products;

- changes in prescription levels;

- the impact of acquisitions, divestitures and other significant corporate transactions, including our acquisition of LipoSonix;

the effect of economic changes in hurricane-effected areas;

manufacturing or supply interruptions;

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

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

the ability to successfully market both new and existing products;

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

the availability of product supply or changes in the cost of raw materials;

the ability to compete against generic and other branded products;

trends toward managed care and health care cost containment;

inadequate protection of our intellectual property or challenges to the validity or enforceability of our proprietary rights and our ability to secure patent protection from filed patent applications for our primary products, including SOLODYN®;

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

legal defense costs, insurance expenses, settlement costs and the risk of an adverse decision or settlement related to product liability, patent protection, government investigations, and other legal proceedings (see Part II, Item 1, Legal Proceedings);

changes in U.S. generally accepted accounting principles;

additional costs related to compliance with changing regulation of corporate governance and public financial disclosure;

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

any changes in business, political and economic conditions due to the threat of future terrorist activity in the U.S. and other parts of the world;

access to available and feasible financing on a timely basis;

the availability of product acquisition or in-licensing opportunities;

the risks and uncertainties normally incident to the pharmaceutical and medical device industries, including product liability claims;

the risks and uncertainties associated with obtaining necessary FDA approvals;

the inability to obtain required regulatory approvals for any of our pipeline products, such as RELOXIN®;

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

downturns in general economic conditions that negatively affect our dermal restorative and branded prescription products, and our ability to accurately forecast our financial performance as a result;

adverse developments relating to the restatement of our consolidated financial statements;

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

the inability to successfully integrate newly-acquired entities, such as LipoSonix.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to review any future disclosures contained in the reports that we file with the SEC. Our amended Annual Report on Form 10-K/A for the year ended December 31, 2007 and this Quarterly Report contain discussions of various risks relating to our business that could cause actual results to differ materially from expected and historical results, which you should review. You should understand that it is not possible to predict or identify all such risks. Consequently, you should not consider any such list or discussion to be a complete set of all potential risks or uncertainties.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2008, there were no material changes to the information previously reported under Item 7A in our amended Annual Report on Form 10-K/A for the year ended December 31, 2007.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) that are designed to ensure that information required to be disclosed in reports filed by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In connection with the restatement discussed elsewhere in this Form 10-Q and in Note 2 to our condensed consolidated financial statements, under the direction of our Chief Executive Officer and Chief Financial Officer, management conducted a reevaluation of the effectiveness of our internal control over financial reporting as of September 30, 2008. The framework on which such evaluation was based is contained in the report entitled Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Report). Based on the evaluation and the criteria set forth in the COSO Report, management identified a material weakness in internal control over financial reporting described in the management s report on internal control over financial reporting included in Item 9A to our 2007 Form 10-K/A and outlined below. Under Audit Standard No. 5, a material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management identified the following material weakness that continued to exist as of September 30, 2008 and the date of this filing:

There was a material weakness in our internal controls over the interpretation and application of Statement of Financial Accounting Standards No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48), as it applies to the calculation of our sales returns reserve. Specifically, the design of controls over the preparation and review of the sales return reserve did not detect that our method of accounting for returns of short-dated and expired goods was not in conformity with generally accepted accounting principles. The lack of sufficient oversight and supervision of operational and accounting personnel led to our failure to identify the misinterpretation of SFAS 48, with respect to our sales return reserve calculation. As a result, management did not detect its error in accounting for sales return reserves, resulting in the restatement of our previously issued consolidated financial statements for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008.

Based on its assessment, including consideration of the aforementioned material weakness, and the criteria discussed above, management concluded that our internal control over financial reporting was not effective at a reasonable assurance level as of September 30, 2008 and the date of this filing.

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Remediation Steps to Address Material Weakness

As disclosed in our 2007 Form 10-K/A, management has dedicated significant resources to correct the accounting error relating to our sales return reserve and to ensure that we take proper steps to improve our internal controls and remedy our material weakness in our financial reporting and disclosure controls. Management is committed to implementing effective control policies and procedures and will continually update our Audit Committee as to the progress and status of our remediation efforts to ensure that they are adequately implemented. We believe that the following actions that we have taken and are taking will be sufficient to remediate the material weakness described above:

- conduct a full review of our accounting methodology for sales return reserves;
- assess the technical accounting capabilities of the accounting and finance departments to ensure the proper knowledge, skills, and training; and
- finance and accounting personnel to attend training sessions covering relevant topics, which include revenue recognition and related accounting concepts.

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

Management believes that the actions described above will remediate the material weakness we have identified and strengthen our internal control over financial reporting. We expect that the material weakness will be fully remediated prior to December 31, 2008. As management improves our internal control over financial reporting and implements remediation measures, we may supplement or modify the remediation measures described above. Further, management believes that, as a result of management s in-depth review of its accounting processes, the utilization of external resources and the additional procedures management has implemented, there are no material inaccuracies or omissions of material fact in this Form 10-Q and, to the best of our knowledge, we believe that the consolidated financial statements in this Form 10-Q fairly present in all material aspects the financial condition, results of operations and cash flows of the Company in conformity with generally accepted accounting principles.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Other than described above, during the three months ended September 30, 2008, there was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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

Part II. Other Information

Item 1. Legal Proceedings

The following supplements and amends the discussion set forth under Part I, Item 3, Legal Proceedings in our amended Annual Report on Form 10-K/A for the year ended December 31, 2007 and Part II, Item 1, Legal Proceedings in our amended Quarterly Report on Form 10-Q/A for the period ended June 30, 2008.

As discussed elsewhere in this Form 10-Q and in Note 2 to our condensed consolidated financial statements, we have restated our financial statements for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008 in an amended Form 10-K/A for the year ended December 31, 2007 and amended Forms 10-Q/A for the quarterly periods ended March 31, 2008 and June 30, 2008. We have discussed this matter with the SEC s Division of Enforcement and have committed to cooperating fully with the SEC in connection with any questions they may have. Consistent with good corporate governance, the Audit Committee of our Board of Directors, working with its independent counsel and forensic accountants, conducted an independent inquiry into the matters giving rise to our need to restate our financial statements (the Internal Inquiry). After completing the Internal Inquiry, the Audit Committee concluded that the need to restate our consolidated financial statements was not the result of any fraud or intentional wrongdoing on the part of any of our directors, officers or other employees. The Audit Committee also noted that our independent registered public accounting firm, Ernst & Young LLP, was aware of and discussed with us on several occasions in the past our methodology of accounting for sales return reserves. Neither the Company nor Ernst & Young LLP has previously identified the misinterpretation and misapplication of generally accepted accounting principles with respect to our sales return reserves prior to the PCAOB review, and Ernst & Young LLP expressed unqualified opinions on our consolidated financial statements and our internal control over financial reporting for each of the now-restated annual and transition periods.

On October 3, 10, and 27, 2008, purported stockholder class action lawsuits styled Andrew Hall v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01821-MHB); Steamfitters Local 449 Pension Fund v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01870-DKD); and Darlene Oliver v. Medicis Pharmaceutical Corp., et al. (Case No. 2:08-cv-01964-JAT) were filed in the United States District Court for the District of Arizona on behalf of stockholders who purchased our securities during the period between October 30, 2003 and approximately September 24, 2008. The complaints name as defendants Medicis Pharmaceutical Corp. and our Chief Executive Officer and Chairman of the Board, Jonah Shacknai, our Chief Financial Officer, Executive Vice President and Treasurer, Richard D. Peterson, and our Chief Operating Officer and Executive Vice President, Mark A. Prygocki. Plaintiffs claims arise in connection with the restatement of our annual, transition, and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008. The complaints allege violations of federal securities laws, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5, based on alleged material misrepresentations to the market that had the effect of artificially inflating the market price of our stock. The plaintiffs seek to recover unspecified damages and costs, including counsel and expert fees. We intend to vigorously defend the claims in these matters. There can be no assurance, however, that we will be successful, and an adverse resolution of the lawsuits could have a material adverse effect on our financial position and results of operations in the period in which the lawsuits are resolved. We are not presently able to reasonably estimate potential losses, if any, related to the lawsuits.

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On April 30, 2008, we received notice from Perrigo Israel Pharmaceuticals Ltd. (Perrigo Israel), a generic pharmaceutical company, that it had filed an Abbreviated New Drug Application with the FDA for a generic version of our VANOS® fluocinonide cream 0.1%. Perrigo Israel s notice indicated that it was challenging only one of the two patents that we listed with the FDA for VANOS® cream. On June 6, 2008, we filed a complaint for patent infringement against Perrigo Israel and its domestic corporate parent Perrigo Company in the United States District Court for the Western District of Michigan. The complaint asserts that Perrigo Israel and Perrigo Company have infringed both of our patents for VANOS® Cream.

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

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

On May 25, 2006, Prasco Laboratories of Cincinnati, Ohio filed suit against us and Imaginative Research Associates (IRA) seeking a declaration that Prasco s Oscion product does not infringe certain patents owned by us or by IRA. We and IRA moved to dismiss that suit on the grounds that the court had no jurisdiction under the Declaratory Judgment Act to hear the case. The court granted our motion and dismissed the case. Prasco has appealed and the appeal is pending before the U.S. Court of Appeals for the Federal Circuit. The case was argued to the U.S. Court of Appeals on April 10, 2008.

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

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Item 1A. Risk Factors

We operate in a rapidly changing environment that involves a number of risks. The following discussion highlights some of these risks and others are discussed elsewhere in this report. These and other risks could materially and adversely affect our business, financial condition, prospects, operating results or cash flows. The risk factors presented below supplement and amend the risk factors previously disclosed by us in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 and our subsequent reports on Forms 10-Q and 8-K.

Risks Related To Our Business

The restatement of our consolidated financial statements has subjected us to a number of additional risks and uncertainties, including increased costs for accounting and legal fees and the increased possibility of legal proceedings.

As discussed elsewhere in this Form 10-Q and in Note 2 to our condensed consolidated financial statements, we determined that our consolidated financial statements for the annual, transition and quarterly periods in fiscal years 2003 through 2007 and the first and second quarters of 2008 should be restated due to an error in our interpretation and application of SFAS 48 as it applies to a component of our sales return reserve calculations. As a result of the restatement, we have become subject to a number of additional risks and uncertainties, including:

We incurred substantial unanticipated costs for accounting and legal fees in connection with the restatement. Although the restatement is complete, we expect to continue to incur accounting and legal costs as noted below.

As a result of the restatement, we have been named in a number of lawsuits as discussed in Item 1 of Part II of this report, Legal Proceedings and Note 19, Commitments and Contingencies. The plaintiffs in these lawsuits may make additional claims, expand existing claims and/or expand the time periods covered by the complaints. Other plaintiffs may bring additional actions with other claims, based on the restatement. If such events occur, we may incur substantial defense costs regardless of the outcome of these actions and insurance and indemnification may not be sufficient to cover the losses we may incur. Likewise, such events might cause a diversion of our management s time and attention. If we do not prevail in one or more of these actions, we could be required to pay substantial damages or settlement costs, which could adversely affect our business, financial condition, results of operations and liquidity.

Management recently identified a material weakness in our internal control over financial reporting with respect to our interpretation and application of SFAS 48 to the calculation of sales return reserves. Additionally, management may identify material weaknesses in the future that could adversely affect investor confidence, impair the value of our common stock and increase our cost of raising capital.

In connection with the restatement, we have assessed the effectiveness of our disclosure controls and procedures. Management identified a material weakness in our internal control over financial reporting with respect to our interpretation and application of SFAS 48 to the calculation of sales return reserves. As a result of this material weakness, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective at a reasonable assurance level as of December 31, 2007 and the date of the date of this filing. In response, we have adopted a sales return reserve methodology that we believe complies with the requirements of SFAS 48. Management has taken and is taking steps to remediate the material weakness in our internal control over financial reporting. There can be no assurance as to how quickly or effectively our remediation steps will remediate the material weakness in our internal control over financial reporting or that additional material weaknesses will not be identified in the future.

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Any failure to remedy additional deficiencies in our internal control over financial reporting that may be discovered in the future or to implement new or improved controls, or difficulties encountered in the implementation of such controls, could harm our operating results, cause us to fail to meet our reporting obligations or result in material misstatements in our financial statements. Any such failure could, in turn, affect the future ability of our management to certify that our internal control over our financial reporting is effective and, moreover, affect the results of our independent registered public accounting firm s attestation report regarding our management s assessment. Inferior internal control over financial reporting could also subject us to the scrutiny of the SEC and other regulatory bodies and could cause investors to lose confidence in our reported financial information, which could have an adverse effect on the trading price of our common stock.

In addition, if we or our independent registered public accounting firm identify additional deficiencies in our internal control over financial reporting, the disclosure of that fact, even if quickly remedied, could reduce the market s confidence in our financial statements and harm our share price. Furthermore, additional deficiencies could result in future non-compliance with Section 404 of the Sarbanes-Oxley Act of 2002. Such non-compliance could subject us to a variety of administrative sanctions, including the suspension or delisting of our ordinary shares from the NYSE and review by the NYSE, the SEC, or other regulatory authorities.

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

We depend upon patents to provide us with exclusive marketing rights for certain of our primary products for some period of time. If product patents for our primary products expire, or are successfully challenged by our competitors, in the United States and in other countries, we would face strong competition from lower price generic drugs. Loss of patent protection for any of our primary products would likely lead to a rapid loss of sales for that product, as lower priced generic versions of that drug become available. In the case of products that contribute significantly to our sales, the loss of patent protection could have a material adverse effect on our results of operations.

We currently have one issued patent relating to SOLODYN® that does not expire until 2018. As part of our patent strategy, we are currently pursuing additional patent applications for SOLODYN®. However, we cannot provide any assurance that any additional patents will be issued relating to SOLODYN®. For example, on June 16, 2008, we announced that we received final rejections from the USPTO with respect to two of our patent applications relating to SOLODYN® (application numbers 11/776,669 and 11/776,711). The failure to obtain additional patent protection could adversely affect our ability to deter generic competition, which would adversely affect SOLODYN® revenue and our results of operations.

In addition, SOLODYN® may face generic competition in the near future without prior notice if a generic competitor decides to enter the market notwithstanding the risk of a suit for patent infringement. Because SOLODYN® contains an antibiotic drug that was first approved by the FDA prior to the enactment of the Food and Drug Administration Modernization Act of 1997, or FDAMA, SOLODYN® does not have the benefit of the protections offered under the Hatch-Waxman Act. Accordingly, we would not receive a Paragraph IV notice regarding SOLODYN® from any potential generic competitor and would not be entitled to an automatic 30-month stay of generic entry that would be available to a patent owner filing an infringement suit based on receipt of such a notice.

On January 15, 2008, we announced that IMPAX Laboratories, Inc. (IMPAX) sent us a letter advising that IMPAX has filed an ANDA seeking FDA approval to market a generic version of SOLODYN® (minocycline HCl) extended-release capsules. IMPAX has not advised us as to the status of the FDA s review of its filing, or whether IMPAX has complied with recent FDA requirements for proving bioequivalence. Also on January 15, 2008, IMPAX filed a lawsuit against us in the United States District Court for the Northern District of California seeking a declaratory judgment that our U.S. Patent No. 5,908,838 (the 838 Patent) related to SOLODYN® is invalid and is not infringed by IMPAX s ANDA for a generic version of SOLODYN®. On April 16, 2008, the Court granted Medicis motion to dismiss

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the IMPAX complaint for lack of jurisdiction. IMPAX has appealed the Court s order dismissing the case to the United States Court of Appeals for the Federal Circuit.

On August 18, 2008, we announced that the United States Patent and Trademark Office (USPTO) has granted a Request for Ex Parte Reexamination of our 838 Patent. During the reexamination process, the USPTO will review the 838 Patent and could determine that the patent claims, as written, were properly allowed. This determination would assist us in defending challenges to the validity of the 838 Patent. Alternatively, the USPTO could narrow or reject certain or all of the claims of the 838 Patent. Depending upon the specifics of what narrowing amendments are required and the claims rejected, these determinations of the USPTO could have a material adverse impact on our results of operations. The timing of the USPTO s completion of the reexamination is uncertain. We believe that the USPTO should reconfirm the validity of the 838 Patent. However, there can be no guarantee as to the outcome.

In addition to SOLODYN®, our other primary prescription products, including VANOS®, may be subject to generic competition in the near future. For example, on May 1, 2008, we announced that Perrigo Israel Pharmaceuticals Ltd. (Perrigo) filed an ANDA with the FDA for a generic version of VANOS®. Perrigo has not advised us as to the timing or status of the FDA s review of its filing. Perrigo s certification letter sets forth allegations that our U.S. Patent No. 6,765,001 is invalid, unenforceable and/or will not be infringed by Perrigo s manufacture, use, or sale of the product for which the ANDA was submitted. If any of our primary products are rendered obsolete or uneconomical by competitive changes, including generic competition, our results of operation would be materially and adversely affected.

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

Our short-term and long-term investments consist of corporate and various government agency and municipal debt securities and auction rate floating securities. As of September 30, 2008, our investments included $39.9 million of auction rate floating securities. Our auction rate floating securities are debt instruments with a long-term maturity and with an interest rate that is reset in short intervals through auctions. The recent negative conditions in the credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate floating securities. During the three months ended March 31, 2008, we were informed that there was insufficient demand at auction for the auction rate floating securities. As a result, these affected auction rate floating securities are now considered illiquid, and we could be required to hold them until they are redeemed by the holder at maturity. We may not be able to make the securities liquid until a future auction on these investments is successful.

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Item 6. Exhibits

Exhibit 31.1+	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2+	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1+	Certification by the Chief Executive Officer and the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

+ Filed herewith

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MEDICIS PHARMACEUTICAL CORPORATION

Date: November 10, 2008

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

Date: November 10, 2008

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