ATRIX LABORATORIES INC
Form 10-Q
August 01, 2003

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2003

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 0-18231

ATRIX LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**84-1043826** (I.R.S. Employer Identification No.)
2579 Midpoint Drive, Fort Collins, Colorado (Address of principal executive office)	**80525** (Zip Code)

Registrant s telephone number, including area code: **(970) 482-5868**

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

The number of shares outstanding of the registrant s common stock as of July 31, 2003, was 20,965,630.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)
(Unaudited)

	June 30, 2003	December 31, 2002
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 16,958	$ 30,698
Marketable securities available-for-sale, at fair value	81,087	81,767
Accounts receivable, net of allowance for doubtful accounts of $781 and $623	7,208	6,140
Interest receivable	518	679
Inventories, net of reserve of $205 and $0	11,237	8,694
Prepaid expenses and deposits	3,232	2,253
Total current assets	120,240	130,231
PROPERTY, PLANT AND EQUIPMENT, NET	21,954	15,431
OTHER ASSETS:		
Goodwill	399	399
Intangible and other assets, net of accumulated amortization of $3,567 and $3,116	3,039	3,964
Other assets	3,438	4,363
TOTAL ASSETS	$ 145,632	$ 150,025
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable trade	$ 2,618	$ 7,261
Accrued expenses and other	1,023	1,042
Deferred revenue	9,905	7,889
Total current liabilities	13,546	16,192
DEFERRED REVENUE	37,400	37,064
COMMITMENTS AND CONTINGENCIES		
CONVERTIBLE EXCHANGEABLE PREFERRED STOCK:		
Series A convertible exchangeable preferred stock, $.001 par value, 20,000 shares authorized; 14,274 an 13,787 shares issued and outstanding. Liquidation preference $14,720 and $14,227	15,008	14,514
SHAREHOLDERS EQUITY:		

Preferred stock, $.001 par value; 5,000,000 shares authorized Series A preferred stock, $.001 par value, 200,000 shares authorized, none issued or outstanding		
Common stock, $.001 par value; 45,000,000 shares authorized; 20,822,189 and 20,516,069 shares issued and 19,955,389 and 19,858,369 shares outstanding	21	21
Additional paid-in capital	245,517	242,699
Treasury stock, 866,800 and 657,700 shares, at cost	(13,615)	(10,740)
Accumulated other comprehensive income	2,776	1,590
Accumulated deficit	(155,021)	(151,315)
Total shareholders equity	79,678	82,255
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 145,632	$ 150,025

See notes to the consolidated financial statements.

2

Table of Contents

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(Unaudited)

	For the Three Months Ended June 30,	
	2003	**2002**
REVENUES:		
Net sales and royalties	$ 4,563	$ 1,474
Contract research and development revenue	5,689	3,513
Licensing, marketing rights and milestone revenue	2,091	1,497
Total revenues	12,343	6,484
OPERATING EXPENSE:		
Cost of sales	1,862	792
Research and development	9,277	7,512
Administrative and marketing	2,636	2,407
Gain on extinguished debt		(44)
Total operating expenses	13,775	10,667
LOSS FROM OPERATIONS	(1,432)	(4,183)
OTHER INCOME (EXPENSE):		
Equity in loss of joint venture	(4)	(335)
Investment income and expense, net	681	1,154
Gain (loss) on sale and write-down of marketable securities	309	(1,005)
Other	(17)	(6)
Net other income (expense)	969	(192)
NET LOSS	(463)	(4,375)
Accretion of dividends on preferred stock	(249)	(233)
NET LOSS APPLICABLE TO COMMON STOCK	$ (712)	$ (4,608)
Basic and diluted loss per common share:		
Net loss	$ (.02)	$ (.22)
Accretion of dividends on preferred stock	(.02)	(.01)
Net loss applicable to common stock	$ (.04)	$ (.23)
Basic and diluted weighted average common shares outstanding	19,773,194	20,229,830

See notes to the consolidated financial statements.

Table of Contents

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(Unaudited)

	For the Six Months Ended June 30,	
	2003	**2002**
REVENUES:		
Net sales and royalties	$ 7,783	$ 2,632
Contract research and development revenue	9,999	6,008
Licensing, marketing rights and milestone revenue	4,022	2,859
Total revenues	21,804	11,499
OPERATING EXPENSES:		
Cost of sales	3,290	1,303
Research and development	17,969	14,074
Administrative and marketing	5,491	4,230
Administrative stock option compensation	22	1,256
Gain on extinguished debt		(30)
Total operating expenses	26,772	20,833
LOSS FROM OPERATIONS	(4,968)	(9,334)
OTHER INCOME (EXPENSE):		
Equity in loss of joint venture	(77)	(745)
Investment income and expense, net	1,420	2,380
Gain (loss) on sale and write-down of marketable securities	428	(1,076)
Debt conversion expense		(125)
Other	(16)	(5)
Net other income	1,755	429
NET LOSS	(3,213)	(8,905)
Accretion of dividends on preferred stock	(494)	(461)
NET LOSS APPLICABLE TO COMMON STOCK	$ (3,707)	$ (9,366)
Basic and diluted loss per common share:		
Net loss	$ (.16)	$ (.45)
Accretion of dividends on preferred stock	(.03)	(.02)
Net loss applicable to common stock	$ (.19)	$ (.47)
Basic and diluted weighted average common shares outstanding	19,757,480	20,079,496

See notes to the consolidated financial statements.

Table of Contents

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)
(Unaudited)

	For the Six Months Ended June 30,	
	2003	**2002**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (3,213)	$ (8,905)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,570	1,557
Amortization of deferred revenue	(4,907)	(4,274)
Equity in loss of joint venture	77	745
Loss (gain) on sale and write-down of marketable securities	(428)	1,076
Stock and stock option compensation	22	1,256
Debt conversion expense		125
Interest expense converted to equity		110
Gain on extinguished debt		(30)
Other non-cash items	60	8
Net changes in operating assets and liabilities:		
Accounts receivable	(888)	6
Interest receivable	161	108
Inventories	(2,484)	(1,460)
Prepaid expenses and deposits	(978)	(1,361)
Accounts payable	(5,145)	(249)
Accrued expenses and other	(28)	882
Deferred revenue	7,160	10,095
Net cash used in operating activities	(9,021)	(311)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property, plant and equipment	(6,564)	(1,812)
Investment in intangible and other assets	(395)	(419)
Proceeds from maturity and sale of marketable securities	23,189	15,067
Investment in marketable securities	(21,264)	(27,873)
Investment in joint venture	(207)	(1,178)
Net cash used in investing activities	(5,241)	(16,215)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of equity securities, net of issuance costs	2,796	2,532
Payments to acquire treasury stock	(2,876)	(671)
Net cash provided by (used in) financing activities	(80)	1,861
NET EFFECT OF EXCHANGE RATE ON CASH	602	346
NET DECREASE IN CASH AND CASH EQUIVALENTS	(13,740)	(14,319)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	30,698	50,058

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 16,958	$ 35,739

Non-cash investing and financing activities (in thousands):

2003

Issued restricted common stock valued at $22 as part of employment separation agreements.

Issued preferred stock valued at $487 to Elan for accreted dividends.

Long-term deposits on equipment of $869 were reclassified to property, plant and equipment

2002

Issued common stock valued at $5,331 in exchange for $5,206 of the 7% Convertible Subordinated Notes.

Vested incentive stock options valued at $1,257 for an executive officer in conjunction with a termination agreement.

See notes to the consolidated financial statements.

Table of Contents

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the Six Months Ended June 30, 2003 and 2002

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Atrix Laboratories, Inc. and its subsidiaries (collectively referred to as Atrix or the Company) have been prepared in accordance with generally accepted accounting principles for interim consolidated financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments considered necessary, consisting of normal recurring accruals, for a fair presentation have been included. Operating results for the six months ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, for the year ended December 31, 2002, filed with the Securities and Exchange Commission (the SEC), in the Company s Annual Report on Form 10-K.

NOTE 2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Atrix Laboratories, Inc. was formed in August 1986 as a Delaware corporation. In November 1998, the Company acquired ViroTex Corporation. In June 1999, the Company organized its wholly owned subsidiary Atrix Laboratories Limited, which is based in London, England. In February 2000, the Company organized its wholly owned subsidiary Atrix Laboratories GmbH, which is based in Frankfurt, Germany, to conduct its European operations. In June 2000, the Company entered into a research joint venture, Transmucosal Technologies, Ltd., with Elan International Services, Ltd. (Elan), a wholly owned subsidiary of Elan Corporation, plc.

Atrix is an emerging specialty pharmaceutical company focused on advanced drug delivery. With five unique patented drug delivery technologies, the Company is currently developing a diverse portfolio of products, including proprietary oncology, dermatology and pain management products. The Company also forms strategic alliances with a variety of pharmaceutical and biotechnology companies to develop products utilizing various drug delivery systems and/or to commercialize products. These strategic alliances include collaborations with Pfizer Inc., Sanofi-Synthelabo Inc., Fujisawa Healthcare, Inc., Geneva Pharmaceuticals, Inc., Sosei Co. Ltd., MediGene AG, and CollaGenex Pharmaceuticals, Inc.

Critical Accounting Policies

Principles of consolidation

The accompanying consolidated financial statements include the accounts of Atrix and its wholly owned subsidiaries Atrix Laboratories Limited and Atrix Laboratories, GmbH. All significant intercompany transactions and balances have been eliminated. While the Company initially owns 80.1% of Transmucosal Technologies outstanding common stock, Elan and its subsidiaries have retained significant minority investor rights that are considered participating rights as defined in Emerging Issues Task Force Consensus 96-16, Investor s Accounting for an Investee When the Investor Has a Majority of the Voting Interest, but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. Elan s significant rights in Transmucosal Technologies that are considered participating rights include equal representation in the management of the joint venture and development of its business plan and approval rights on the board of directors as it relates to the business plan. Accordingly, the Company accounts for its investment in Transmucosal Technologies under the equity method of accounting. Additionally, the joint venture contracts with Atrix to perform certain research and development activities.

Revenue recognition

The Company recognizes revenue on product sales and contract manufacturing at the time of shipment when title to the product transfers and the customer bears risk of loss. Royalty revenue is recorded when product is

Table of Contents

shipped by licensees based on the invoiced amount by the licensee and royalty rates as specified in the agreement with the licensee.

All contract research and development is performed on a best effort basis under signed contracts. Revenue under contracts with a fixed price is recognized over the term of the agreement on a straight-line basis, which is consistent with the pattern of work performed. Billings are made in accordance with schedules as specified in each agreement, which generally include an up-front payment as well as periodic payments. Payments received in advance of revenue recognition are recorded as deferred revenue. Revenue under other contracts is recognized based on terms as specified in the contracts, including billings for time incurred at rates as specified in the contracts and as reimbursable expenses are incurred. Such arrangements are regularly evaluated on an individual basis. Billings under the contracts are made monthly.

The Company has licensing agreements that generally provide for non-refundable license fees and/or milestone payments. The licensing agreements typically require a non-refundable license fee and allow the Company s partners to sell its proprietary products in a defined territory for a defined period. Non-refundable license fees are initially reported as deferred revenue and recognized as contract revenue over the remaining contractual term using the straight-line method or until the agreement is terminated. License fees received in connection with arrangements where the Company has no continuing involvement are recognized as revenue when the amounts are received or when collection of the license fee is assured, whichever is earlier. A milestone payment is a payment made by a corporate partner to the Company upon the achievement of a pre-determined milestone as defined in the applicable agreement. Milestone payments are initially reported as deferred revenue and recognized as milestone revenue over the remaining contractual term using the straight-line method when the milestone event has occurred and the Company has completed all milestone-related services such that the milestone payment is currently due and is non-refundable.

Research and Development

Costs incurred in connection with research and development activities are expensed as incurred. These costs consist of direct and indirect costs associated with specific projects, as well as fees paid to various entities that perform certain research on the Company s behalf. Additionally, licensing fees paid by the Company to acquire technology are expensed as incurred if no alternative future use exists. A portion of overhead costs is allocated to research and development on a weighted-average percentage basis among all projects under development.

The following table summarizes research and development activities funded, in whole or in part, by our collaborators, as well as research and development activities funded by the Company for the six months ended June 30 (amounts in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2003	**2002**	**2003**	**2002**
Research and Development Funded	$ 7,706	$ 3,649	$ 13,624	$ 6,865
Research and Development Not Funded	1,571	3,863	4,345	7,209
Research and Development	$ 9,277	$ 7,512	$ 17,969	$ 14,074

Pro Forma Effect of Stock Option Issuances

The Company accounts for options under the Performance Stock Option Plan, the 2000 Stock Incentive Plan, the Non-Qualified Stock Option Plan and the 1999 Non-Employee Director Stock Incentive Plan using the intrinsic value method as permitted by SFAS No. 123. Accordingly, no compensation expense has been recognized for stock option grants. Had compensation cost been determined based on the fair value of the options at the grant dates of awards under the 1987 Plan, 2000 Plan and DSI Plan consistent with SFAS No. 123, the Company s net loss applicable to common stock and basic and diluted loss per common share would have been changed to the pro forma amounts indicated below (net loss applicable to common stock amounts in thousands):

Table of Contents

	Three months ended June 30,	Six months ended June 30,