

DUSA PHARMACEUTICALS INC

Form 10-Q

August 02, 2012

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2012

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

For the transition period from to

Commission file number: 001-31533

DUSA PHARMACEUTICALS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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New Jersey
(State of Other Jurisdiction of

22-3103129
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

25 Upton Drive, Wilmington, MA
(Address of Principal Executive Offices)

01887
(Zip Code)

(978) 657-7500

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 ☒ No ☐

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

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

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

As of August 1, 2012, the registrant had 25,001,008 shares of Common Stock, no par value per share, outstanding.

Table of Contents

DUSA PHARMACEUTICALS, INC. TABLE OF CONTENTS TO FORM 10-Q

	Page Number
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
- Consolidated Balance Sheets at June 30, 2012 and December 31, 2011 (Unaudited)	3
- Consolidated Statements of Operations for the three and six-month periods ended June 30, 2012 and 2011 (Unaudited)	4
- Consolidated Statements of Comprehensive Income for the three and six-month periods ended June 30, 2012 and 2011 (Unaudited)	5
- Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2012 and 2011 (Unaudited)	6
- Notes to the Consolidated Financial Statements (Unaudited)	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	19
<u>Item 4. Controls and Procedures</u>	20
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	21
<u>Item 1A. Risk Factors</u>	21
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
<u>Item 3. Defaults Upon Senior Securities</u>	29
<u>Item 4. Mine Safety Disclosures</u>	29
<u>Item 5. Other Information</u>	30
<u>Item 6. Exhibits</u>	30
<u>SIGNATURES</u>	31
<u>Exhibit Index</u>	32
<u>EX-10.1</u>	
<u>EX-10.2</u>	
<u>EX-10.3</u>	
<u>EX-10.4</u>	
<u>EX-10.5</u>	
<u>EX-10.6</u>	
<u>EX-10.7</u>	
<u>EX-31.A</u>	
<u>EX-31.B</u>	
<u>EX-32.A</u>	
<u>EX-32.B</u>	
<u>EX-99.1</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

Table of Contents**PART I.****ITEM 1. FINANCIAL STATEMENTS
DUSA PHARMACEUTICALS, INC.****CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

	June 30, 2012	December 31, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 26,560,253	\$ 24,423,682
Marketable securities, at fair value	4,775,828	3,791,942
Accounts receivable, net of allowance for doubtful accounts of \$43,000 and \$50,000 in 2012 and 2011, respectively	2,636,621	3,729,303
Inventory	3,403,328	2,823,173
Prepaid and other current assets	1,029,728	1,380,763
Current assets of discontinued operations		38,671
TOTAL CURRENT ASSETS	38,405,758	36,187,534
Restricted cash	176,032	175,810
Property, plant and equipment, net	1,783,959	1,601,101
Deferred charges and other assets	71,878	57,833
TOTAL ASSETS	\$ 40,437,627	\$ 38,022,278
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 1,110,165	\$ 803,639
Accrued compensation	1,082,004	2,351,342
Other accrued expenses	3,050,417	2,459,562
Current liabilities of discontinued operations	248,649	851,775
TOTAL CURRENT LIABILITIES	5,491,235	6,466,318
Deferred revenues	893,232	900,769
Warrant liability	2,823,063	2,216,763
Other liabilities	144,061	157,238
TOTAL LIABILITIES	9,351,591	9,741,088
COMMITMENTS AND CONTINGENCIES (NOTE 9)		
SHAREHOLDERS' EQUITY		
Capital Stock Authorized: 100,000,000 shares; 40,000,000 shares designated as common stock, no par, and 60,000,000 shares issuable in series or classes; and 40,000 junior Series A preferred shares. Issued and outstanding: 25,001,008 and 24,649,614 shares of common shares, no par, at June 30, 2012 and December 31, 2011, respectively	151,774,972	151,985,930
Additional paid-in capital	11,788,877	10,606,654

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Accumulated deficit	(132,489,191)	(134,336,998)
Accumulated other comprehensive income	11,378	25,604

TOTAL SHAREHOLDERS' EQUITY	31,086,036	28,281,190
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TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 40,437,627	\$ 38,022,278
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See the accompanying Notes to the Consolidated Financial Statements.

Table of Contents

DUSA PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three months ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2012	2011	2012	2011
Product revenues	\$ 11,726,106	\$ 9,671,254	\$ 25,146,791	\$ 20,652,943
Cost of product revenues	1,778,078	1,471,153	3,847,946	3,101,717
GROSS MARGIN	9,948,028	8,200,101	21,298,845	17,551,226
Operating costs:				
Research and development	2,206,877	1,108,774	4,257,640	2,432,418
Marketing and sales	4,000,951	3,288,573	8,634,530	7,261,797
General and administrative	2,874,681	2,550,287	5,957,451	5,003,034
TOTAL OPERATING COSTS	9,082,509	6,947,634	18,849,621	14,697,249
INCOME FROM OPERATIONS	865,519	1,252,467	2,449,224	2,853,977
Other income	1,904	19,533	4,883	35,987
Gain (loss) on change in fair value of warrants	1,317,506	(875,437)	(606,300)	(3,064,370)
INCOME (LOSS) FROM CONTINUING OPERATIONS	2,184,929	396,563	1,847,807	(174,406)
INCOME FROM DISCONTINUED OPERATIONS		714,032		680,101
NET INCOME	\$ 2,184,929	\$ 1,110,595	\$ 1,847,807	\$ 505,695
BASIC NET INCOME (LOSS) PER SHARE CONTINUING OPERATIONS	\$ 0.09	\$ 0.02	\$ 0.07	\$ (0.01)
DISCONTINUED OPERATIONS	\$	\$ 0.03	\$	\$ 0.03
BASIC NET INCOME PER SHARE	\$ 0.09	\$ 0.05	\$ 0.07	\$ 0.02
DILUTED NET INCOME (LOSS) PER SHARE CONTINUING OPERATIONS	\$ 0.08	\$ 0.01	\$ 0.07	\$ (0.01)
DISCONTINUED OPERATIONS	\$	\$ 0.03	\$	\$ 0.03
DILUTED NET INCOME PER SHARE	\$ 0.08	\$ 0.04	\$ 0.07	\$ 0.02
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, BASIC	24,951,545	24,539,627	24,835,418	24,412,221
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, DILUTED	26,914,805	26,813,329	26,902,570	26,334,058

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See the accompanying Notes to the Consolidated Financial Statements.

Table of Contents

DUSA PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
NET INCOME	\$ 2,184,929	\$ 1,110,595	\$ 1,847,807	\$ 505,695
Change in net unrealized gains on marketable securities, available-for-sale	(7,060)	(4,533)	(14,226)	(28,169)
COMPREHENSIVE INCOME	\$ 2,177,869	\$ 1,106,062	\$ 1,833,581	\$ 477,526

Table of Contents**DUSA PHARMACEUTICALS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	Six months ended	
	June 30,	
	2012	2011
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES		
Net income	\$ 1,847,807	\$ 505,695
Less: income from discontinued operations		(680,101)
Net income (loss) from continuing operations	1,847,807	(174,406)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Accretion of premiums and discounts on marketable securities	597	(9,676)
Share-based compensation	1,182,223	571,621
Depreciation and amortization	302,619	217,299
Loss on change in fair value of warrants	606,300	3,064,370
Deferred revenues recognized	(7,537)	(205,133)
Changes in other assets and liabilities impacting cash flows from operations:		
Accounts receivable	1,092,682	1,119,888
Inventory	(580,155)	(890,168)
Prepaid and other assets	336,990	224,525
Accounts payable, accrued compensation and other accrued expenses	(371,957)	(463,142)
Other liabilities	(13,177)	(14,741)
NET CASH PROVIDED BY OPERATING ACTIVITIES FROM CONTINUING OPERATIONS	4,396,392	3,440,437
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES FROM DISCONTINUED OPERATIONS	(564,455)	231,228
NET CASH PROVIDED BY OPERATING ACTIVITIES	3,831,937	3,671,665
CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES		
Purchases of marketable securities	(1,998,709)	(1,499,337)
Proceeds from maturities and sales of marketable securities	1,000,000	8,865,000
Restricted cash	(222)	(553)
Purchases of property, plant and equipment	(485,477)	(210,202)
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES FROM CONTINUING OPERATIONS	(1,484,408)	7,154,908
NET CASH PROVIDED BY INVESTING ACTIVITIES FROM DISCONTINUED OPERATIONS		750,000
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(1,484,408)	7,904,908
CASH FLOWS FROM FINANCING ACTIVITIES		
Stock option exercises	297,608	515,689
Settlements of restricted stock for tax withholding obligations	(508,566)	(233,757)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(210,958)	281,932
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,136,571	11,858,505

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Decrease (increase) in cash and cash equivalents from discontinued operations	564,455	(981,228)
Increase in cash and cash equivalents from continuing operations	2,701,026	10,877,277
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	24,423,682	8,884,402
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 26,560,253	\$ 20,742,907

See the accompanying Notes to the Consolidated Financial Statements.

Table of Contents

DUSA PHARMACEUTICALS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1) BASIS OF PRESENTATION

The Consolidated Balance Sheet as of June 30, 2012, the Consolidated Statements of Operations and Comprehensive Income for the three and six-month periods ended June 30, 2012 and 2011, and the Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2012 and 2011 of DUSA Pharmaceuticals, Inc. (the Company or DUSA) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). These consolidated financial statements are unaudited but include all normal recurring adjustments, which management of the Company believes to be necessary for fair presentation of the periods presented. The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for any other interim period or for a full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. These consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission. The balance sheet as of December 31, 2011 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

2) FINANCIAL INSTRUMENTS

Fair Value Measurements

The Company's financial instruments at June 30, 2012 and December 31, 2011 consisted primarily of cash and cash equivalents, accounts receivable, marketable securities, accounts payable, and a warrant liability. The Company believes the carrying value of accounts receivable and accounts payable approximates their fair values due to their short-term nature.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, financial instruments are categorized based on a hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

- Level 1: Quoted market prices in active markets for identical assets or liabilities. Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as exchange-traded instruments and listed equities.
- Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data. Level 2 consists of financial instruments that are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency in the determination of value. The Company accesses publicly available market activity from third party databases and credit ratings of the issuers of the securities it holds to corroborate the data used in the fair value calculations obtained from its primary pricing source. The Company also takes into account credit rating changes, if any, of the securities or recent marketplace activity.
- Level 3: Unobservable inputs that are not corroborated by market data. Level 3 is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable. The warrant liability was recorded initially at its fair value using the Black-Scholes option-pricing model and is revalued at each reporting date until the warrants are exercised or expire. The fair value of the warrants is subject to significant fluctuation based on changes in our stock price, expected volatility, remaining contractual life and the risk-free interest rate.

The Company's cash equivalents and investments are classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, or broker dealer quotations and matrix pricing compiled by third party pricing vendors, respectively, which are based on third party pricing sources with reasonable levels of price transparency. The Company's investments are valued based on a market approach in which all significant inputs are observable or can be derived from or corroborated by observable market data such as interest rates, yield curves, and credit risk.

Table of Contents

The following table presents the Company's financial instruments recorded at fair value in the Consolidated Balance Sheet, classified according to the three categories described above:

	Fair Value Measurements at June 30, 2012			
	Carrying Value	(Level 1)	(Level 2)	(Level 3)
Assets				
Cash and cash equivalents	\$ 26,560,000	\$ 26,560,000	\$	\$
United States government-backed securities	4,557,000		4,557,000	
Certificate of Deposit Restricted Cash	176,000	176,000		
Corporate debt securities	219,000		219,000	
Total assets at fair value	\$ 31,512,000	\$ 26,736,000	\$ 4,776,000	\$
Liabilities				
Warrant liability	\$ 2,823,000			\$ 2,823,000
Total liabilities at fair value	\$ 2,823,000	\$	\$	\$ 2,823,000

	Fair Value Measurements at December 31, 2011			
	Carrying Value	(Level 1)	(Level 2)	(Level 3)
Assets				
Cash and cash equivalents	\$ 24,424,000	\$ 24,424,000		
United States government-backed securities	3,569,000		3,569,000	
Certificate of Deposit Restricted Cash	176,000	176,000		
Corporate debt securities	223,000		223,000	
Total assets at fair value	\$ 28,392,000	\$ 24,600,000	\$ 3,792,000	
Liabilities				
Warrant liability	\$ 2,217,000			\$ 2,217,000
Total liabilities at fair value	\$ 2,217,000	\$	\$	\$ 2,217,000

The Company reviewed the level classifications of its investments at June 30, 2012 compared to December 31, 2011 and determined that there were no significant transfers between levels in the six-month period ended June 30, 2012.

The table below includes a rollforward of the balance sheet amounts for the three and six-month periods ended June 30, 2012 and 2011 for the warrant liability, which is classified as Level 3.

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
Three-Month Period Ended June 30, 2012					
Fair Value at April 1, 2012	Total Unrealized Gain Recognized in	Purchases, Sales Issuances, Settlements, net	Transfers In and/or Out of Level 3	Fair Value at June 30, 2012	Change in Unrealized Gains

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Statement of Operations						
Warrant Liability	\$ 4,141,000	\$ (1,318,000)	\$	\$	\$ 2,823,000	\$ 1,318,000

Six-Month Period Ended June 30, 2012						
	Fair Value at January 1, 2012	Total Unrealized Loss Recognized in Statement Of Operations	Purchases, Sales Issuances, Settlements, net	Transfers In and/or Out of Level 3	Fair Value at June 30, 2012	Change in Unrealized Losses
Warrant Liability	\$ 2,217,000	\$ 606,000	\$	\$	\$ 2,823,000	\$ (606,000)

Table of Contents

Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Three-Month Period Ended June 30, 2011

	Fair Value at April 1, 2011	Total Unrealized Loss Recognized in Statement Of Operations	Purchases, Sales Issuances, Settlements, net	Transfers In and/or Out of Level 3	Fair Value at June 30, 2011	Change in Unrealized Losses
Warrant Liability	\$ 3,393,000	\$ 875,000	\$	\$	\$ 4,268,000	\$ (875,000)

Six-Month Period Ended June 30, 2011

	Fair Value at January 1, 2011	Total Unrealized Loss Recognized in Statement Of Operations	Purchases, Sales Issuances, Settlements, net	Transfers In and/or Out of Level 3	Fair Value at June 30, 2011	Change in Unrealized Losses
Warrant Liability	\$ 1,204,000	\$ 3,064,000	\$	\$	\$ 4,268,000	\$ (3,064,000)

Marketable Securities

The Company's marketable securities consist of the following:

June 30, 2012

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
United States government-backed securities	\$ 4,550,000	\$ 7,000	\$	\$ 4,557,000
Corporate securities	215,000	4,000		219,000
Total marketable securities	\$ 4,765,000	\$ 11,000	\$	\$ 4,776,000

December 31, 2011

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
United States government-backed securities	\$ 3,552,000	\$ 17,000	\$	\$ 3,569,000
Corporate securities	215,000	8,000		223,000
Total marketable securities	\$ 3,767,000	\$ 25,000	\$	\$ 3,792,000

The decrease in net unrealized gains on such securities for the three and six-month periods ended June 30, 2012 were \$7,000 and \$14,000, as compared to \$5,000 and \$28,000 in the comparable 2011 periods. Unrealized gains have been recorded in accumulated other comprehensive income in the Consolidated Statements of Comprehensive Income and are reported as part of shareholders' equity in the Consolidated Balance Sheets. There were no realized losses on sales of marketable securities for the three and six-month periods ended June 30, 2012 and 2011. As of June 30, 2012, current yields range from 0.1% to 4.6% and maturity dates range from July 2012 to January 2013.

Common Stock Warrants

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Upon issuance of the warrants on October 29, 2007, the Company recorded the warrant liability at its initial fair value of \$1,950,000. Warrants that are classified as a liability are measured at each reporting date until the warrants are exercised or expire with changes in the fair value reported in the Company's Consolidated Statements of Operations as gain or loss on fair value of warrants. Assumptions used for the Black-Scholes option-pricing models in determining the fair value as of June 30, 2012 and December 31, 2011, include the exercise price of \$2.85 per share, and the following:

	June 30, 2012	December 31, 2011
Expected volatility	53%	61%
Remaining contractual term (years)	0.8	1.3
Risk-free interest rate	0.2%	0.2%
Expected dividend yield	0%	0%
Common stock price	\$ 5.22	\$ 4.38

Table of Contents**3) CONCENTRATIONS**

The Company invests cash in accordance with a policy objective that seeks to preserve both liquidity and safety of principal. The Company manages the credit risk associated with its investments in marketable securities by investing in U.S. government securities and investment grade corporate bonds. The Company's exposure to credit risk relating to its accounts receivable is limited. To manage credit risk in accounts receivable, the Company performs regular credit evaluations of its customers and provides allowances for potential credit losses, when applicable. The Company is dependent upon sole-source suppliers for a number of its products. There can be no assurance that these suppliers will be able to meet the Company's future requirements for such products or parts or that they will be available at favorable terms.

4) INVENTORY

Inventory consisted of the following:

	June 30, 2012	December 31, 2011
Finished goods	\$ 1,553,000	\$ 1,110,000
BLU-U® evaluation units	199,000	225,000
Work in process	248,000	291,000
Raw materials	1,403,000	1,197,000
Total	\$ 3,403,000	\$ 2,823,000

BLU-U® commercial light sources placed in physicians' offices for an initial evaluation period are included in inventory until all revenue recognition criteria are met. The Company amortizes the cost of the evaluation units during the evaluation period to cost of goods sold using an estimated life of three years to approximate its net realizable value.

5) OTHER ACCRUED EXPENSES

Other accrued expenses consisted of the following:

	June 30, 2012	December 31, 2011
Research and development costs	\$ 751,000	\$ 323,000
Marketing and sales costs	318,000	249,000
Other product related costs	870,000	918,000
Legal and other professional fees	493,000	363,000
Employee benefits	390,000	368,000
Other expenses	228,000	239,000
Total	\$ 3,050,000	\$ 2,460,000

6) SHARE-BASED AWARDS

Total share-based compensation expense, related to all of the Company's share-based awards, recognized for the three and six-month periods ended June 30, 2012 and 2011 included the following line items:

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	Three-months ended		Six-months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Cost of product revenues	\$ 32,000	\$ 16,000	\$ 56,000	\$ 25,000
Research and development	75,000	40,000	131,000	67,000
Marketing and sales	121,000	53,000	206,000	107,000
General and administrative	504,000	266,000	789,000	373,000
Share-based compensation expense	\$ 732,000	\$ 375,000	\$ 1,182,000	\$ 572,000

The weighted-average estimated fair value of employee stock options granted during the six-month period ended June 30, 2012 was \$4.05 per share, using the Black-Scholes option valuation model with the following weighted-average assumptions (annualized percentages):

	Six months ended June 30, 2012
Expected volatility	78.1%
Risk-free interest rate	1.0%
Expected dividend yield	0
Expected life-directors and officers (years)	6.1
Expected life-non-officer employees (years)	5.6

There were no stock options granted during the 3-month period ended June 30, 2012.

Table of Contents

A summary of stock option activity for the six-month period ended June 30, 2012 is as follows:

		Weighted Average Exercise Price	Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding, beginning of period, January 1, 2012	2,811,225	\$ 3.97		\$
Options granted	116,300	\$ 6.20		
Options forfeited	(750)	\$ 2.20		
Options expired	(10,625)	\$ 9.73		
Options exercised	(124,001)	\$ 2.40		
Outstanding, end of period	2,792,149	\$ 4.11	3.64	\$ 6,198,000
Exercisable, end of period	2,083,451	\$ 4.58	3.19	\$ 4,327,000
Options vested and expected to vest, end of period	2,728,756	\$ 4.11	3.59	\$ 6,102,000

At June 30, 2012 total unrecognized estimated compensation cost related to stock options was \$970,000 which is expected to be recognized over a weighted average period of 2.0 years.

Unvested Shares Of Common Stock

The Company has issued unvested shares of common stock, which vest over 4 years at a rate of 25% per year, or for members of the Board of Directors, 25% immediately and 25% per year thereafter. The changes in unvested common stock during 2012 and 2011 are as follows:

	2012	2011
Outstanding, beginning of period	900,750	586,000
Shares granted	966,000	506,000
Shares vested	(317,750)	(191,250)
Outstanding, end of period	1,549,000	900,750
Weighted average grant date fair value of shares vested during period	\$ 2.85	\$ 1.88
Weighted average grant date fair value of shares granted during period	\$ 6.14	\$ 4.42
Weighted average grant date fair value of unvested shares, end of period	\$ 5.04	\$ 3.08
Weighted average remaining years to vest	3.07	3.00

At June 30, 2012 total unrecognized estimated compensation cost related to non-vested common shares was \$6,752,000, which is expected to be recognized over a weighted average period of 3.1 years

7) BASIC AND DILUTED NET INCOME PER SHARE

Basic net income per common share is based on the weighted-average number of common shares outstanding during each period. Diluted net income is based on the weighted-average shares outstanding and any contingently issuable shares. The net outstanding shares are adjusted for the dilutive effect of shares issuable upon the assumed conversion of the Company's common stock equivalents, which consist of outstanding

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stock options, warrants and unvested shares of common stock.

	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Weighted average common shares outstanding-basic	24,951,545	24,539,627	24,835,418	24,412,221
Stock options, warrants and unvested shares of common stock	1,963,260	2,273,702	2,067,152	1,921,837
Weighted average common shares outstanding-diluted	26,914,805	26,813,329	26,902,570	26,334,058

Table of Contents

The following were not included in weighted average diluted common shares outstanding because they are anti-dilutive:

	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Stock options	976,000	852,000	945,000	890,000
Unvested shares of common stock	910,000		575,000	
Total	1,886,000	852,000	1,520,000	890,000

8) DISCONTINUED OPERATIONS

At December 31, 2011, the Company ceased marketing and selling its remaining Non-PDT products, primarily ClindaReach® and Meted®. The former Non-PDT Drug Products segment is now reflected as discontinued operations in the accompanying financial statements for all periods presented.

The following is a summary of income from discontinued operations for the three and six-month periods ended June 30, 2012 and 2011:

	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Revenues	\$	\$ 92,000	\$	\$ 192,000
Cost of revenues		123,000		253,000
Gross Margin(1)		(31,000)		(61,000)
Operating Expenses:				
Selling, general and administrative		5,000		9,000
Gain on sale of assets		(750,000)		(750,000)
Total operating expenses		(745,000)		(741,000)
Income from discontinued operations	\$	\$ 714,000	\$	\$ 680,000

- (1) For the three and six-month periods ended June 30, 2011 historical gross margin disclosures for the Non-PDT Drug Products segment included general corporate overhead allocations of \$14,000, and \$28,000, respectively. These amounts have been allocated to continuing operations for purposes of discontinued operations.

The Company includes only revenues and costs directly attributable to the discontinued operations, and not those attributable to the ongoing entity. Accordingly, no general corporate overhead costs have been allocated to the Non-PDT operations for purposes of discontinued operations reporting.

The following is a summary of assets and liabilities associated with discontinued operations at June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
Assets from discontinued operations:		
Accounts receivable, net of allowance for doubtful accounts	\$	\$ 39,000

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Total assets from discontinued operations	\$	\$	39,000
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Liabilities from discontinued operations:

Accounts payable	\$	2,000	\$	3,000
Sales returns reserve		88,000		252,000
Deferred revenues		78,000		78,000
Payment due to former Sirius shareholders				250,000
Non-PDT license payable				250,000
Other		81,000		19,000

Total liabilities from discontinued operations	\$	249,000	\$	852,000
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Table of Contents

The following is a summary of net cash (used in) provided by operating activities from discontinued operations for the six-month periods ended June 30, 2012 and 2011:

	Six-month periods ended	
	June 30, 2012	June 30, 2011
Income from discontinued operations	\$	\$ 680,000
Decrease in assets	39,000	104,000
Increase (decrease) in liabilities	(603,000)	197,000
Gain on sale of assets		(750,000)
Net cash (used in) provided by operating activities from discontinued operations	\$ (564,000)	\$ 231,000
 Proceeds from sale of assets		750,000
Net cash provided by investing activities from discontinued operations	\$	\$ 750,000

The Company establishes an accrual in an amount equal to its estimate of Non-PDT products expected to be returned. The Company determines the estimate of the sales return accrual primarily based on historical experience regarding sales and related returns and incorporating other factors that could impact sales returns in the future. These other factors include, for example, levels of inventory in the distribution channel, estimated shelf life and product discontinuances. The Company's policy is to accept returns when product is within six months of expiration. The Company considers all of these factors and adjusts the accrual periodically to reflect actual experience.

A summary of activity in the Company's sales returns reserve accounts is as follows:

	Balance at January 1, 2012	Provision	Actual Returns or Credits	Balance at June 30, 2012
Sales returns reserve	\$ 252,000	\$	\$ (164,000)	\$ 88,000

	Balance at January 1, 2011	Provision	Actual Returns or Credits	Balance at June 30, 2011
Sales returns reserve	\$ 125,000	\$ 104,000	\$ (42,000)	\$ 187,000

9) COMMITMENTS AND CONTINGENCIES**Lease Arrangements**

The Company leases its facilities under operating leases. The Company's lease arrangements have terms which expire through 2014. Total rent expense under operating leases was approximately \$181,000 and \$175,000 for the six-month periods ended June 30, 2012 and 2011, respectively. Future minimum payments under lease arrangements at June 30, 2012 are as follows:

Years Ending

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December 31,	Operating Lease Obligations
2012	\$ 195,000
2013	396,000
2014	367,000
Total	\$ 958,000

The Company has not accrued amounts for any other potential contingencies as of June 30, 2012.

The Company is involved in legal matters arising in the ordinary course of business. Although the outcome of these matters cannot presently be determined, management does not expect that the resolution of these matters will have a material effect on the Company's financial position or results of operation.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

When you read this section of this report, it is important that you also read the financial statements and related notes included elsewhere in this report. This section contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those we anticipate in these forward-looking statements for many reasons, including the factors described below and in the section entitled "Risk Factors."

Table of Contents

We are a vertically integrated dermatology company that is developing and marketing Levulan® PDT. Our marketed products include Levulan® Kerastick® 20% Topical Solution with PDT and the BLU-U® brand light source.

We devote most of our resources to advancing the development and marketing of our Levulan® PDT technology platform. In addition to our marketed products, our drug, Levulan® brand of aminolevulinic acid HCl, or ALA, in combination with light, has been studied in a broad range of medical conditions. When Levulan® is used and followed with exposure to light to treat a medical condition, it is known as Levulan® PDT. The Kerastick® is our proprietary applicator that delivers Levulan®. The BLU-U® is our patented light device.

The Levulan® Kerastick® 20% Topical Solution with PDT and the BLU-U® were launched in the United States, or U.S., in September 2000 for the treatment of non-hyperkeratotic actinic keratoses, or AKs, of the face or scalp. AKs are precancerous skin lesions caused by chronic sun exposure that can develop over time into a form of skin cancer called squamous cell carcinoma. In addition, in September 2003 we received clearance from the United States Food and Drug Administration, or FDA, to market the BLU-U® without Levulan® PDT for the treatment of moderate inflammatory acne vulgaris and general dermatological conditions.

We are marketing Levulan® PDT under an exclusive worldwide license of patents and technology from PARTEQ Research and Development Innovations, the licensing arm of Queen's University, Kingston, Ontario, Canada. We also own or license certain other patents relating to our BLU-U® device, our Kerastick®, and methods for using pharmaceutical formulations which contain our drug and related processes and improvements. In the United States, DUSA®, DUSA Pharmaceuticals, Inc.®, Levulan®, Kerastick®, and BLU-U® are registered trademarks. Several of these trademarks are also registered in Europe, Australia, Canada, and in other parts of the world. Numerous other trademark applications are pending or have been granted.

We manufacture our Levulan® Kerastick® in our Wilmington, Massachusetts facility. We are responsible for the regulatory, sales, marketing, and customer service and other related activities for our Levulan® Kerastick® and BLU-U®.

CRITICAL ACCOUNTING POLICIES

Our accounting policies are disclosed in Note 2 to the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2011. Since all of these accounting policies do not require management to make difficult, subjective or complex judgments or estimates, they are not all considered critical accounting policies. We have discussed these policies and the underlying estimates used in applying these accounting policies with our Audit Committee. There have been no changes to our critical accounting policies in the six months ended June 30, 2012.

RESULTS OF OPERATIONS THREE AND SIX MONTHS ENDED JUNE 30, 2012 VERSUS JUNE 30, 2011

Revenues Total revenues for the three and six-month periods ended June 30, 2012 were \$11,726,000 and \$25,147,000, respectively, as compared to \$9,671,000 and \$20,653,000 in 2011, and were comprised of the following:

	Three months ended June 30,			Six months ended June 30,		
	2012	2011	Increase/ (Decrease)	2012	2011	Increase/ (Decrease)
LEVULAN® KERASTICK® PRODUCT REVENUES						
United States	\$ 11,184,000	\$ 9,136,000	\$ 2,048,000	\$ 23,798,000	\$ 19,331,000	\$ 4,467,000
Canada	62,000		62,000	62,000	183,000	(121,000)
Korea		83,000	(83,000)		199,000	(199,000)
Subtotal Levulan® Kerastick® product revenues	11,246,000	9,219,000	2,027,000	23,860,000	19,713,000	4,147,000
BLU-U® PRODUCT REVENUES						
United States	474,000	452,000	22,000	1,281,000	940,000	341,000

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Canada	6,000		6,000	6,000		6,000
Subtotal BLU-U® product revenues	480,000	452,000	28,000	1,287,000	940,000	347,000
TOTAL PRODUCT REVENUES	\$ 11,726,000	\$ 9,671,000	\$ 2,055,000	\$ 25,147,000	\$ 20,653,000	\$ 4,494,000

Table of Contents

For the three and six-month periods ended June 30, 2012, total products revenues, comprised of revenues from our Kerastick® and BLU-U® products, were \$11,726,000 and \$25,147,000, respectively. This represents an increase of \$2,055,000 or 21%, and \$4,494,000, or 22%, over the comparable 2011 totals of \$9,671,000 and \$20,653,000, respectively. The increase in revenues was driven by increased Kerastick® and BLU-U® revenues in the United States.

For the three and six-month periods ended June 30, 2012, Kerastick® revenues were \$11,246,000, and \$23,860,000, respectively, representing a \$2,027,000, or 22%, and \$4,147,000, or 21%, increase over the comparable 2011 totals of \$9,219,000, and \$19,713,000, respectively. Kerastick® unit sales to end-users were 74,808 and 158,070 for the three and six-month periods ended June 30, 2012, respectively, including on a year-to-date basis 157,470 sold in the United States and 600 sold in Canada. This represents an increase from 65,706 and 140,919 Levulan® Kerastick® units sold in the three and six-month periods ended June 30, 2011, respectively, including on a year-to-date basis 137,046 sold in the United States, 1,938 sold in Canada, and 1,935 sold in Korea. Our distributor arrangement for Korea was terminated during the third quarter of 2011. Our overall average net selling price for the Kerastick® increased to \$150.85 per unit for the first six months of 2012 from \$139.13 per unit for the first six months of 2011. The increase in 2012 Kerastick® revenues was driven mainly by an increase in sales volumes in the United States as well as an increase in our overall average unit selling price.

For the three and six-month periods ended June 30, 2012, BLU-U® revenues were \$480,000 and \$1,287,000, respectively, representing a \$28,000, or 6%, and \$347,000, or 37%, increase over the comparable 2011 totals of \$452,000 and \$940,000, respectively. On a year-to-date basis, the increase in BLU-U® revenues were due to an increase in our sales volumes, partially offset by a decrease in our overall average selling price. In the three and six-month periods ended June 30, 2012, there were 66 and 180 units sold, respectively, versus 56 and 120 units sold, respectively, in the comparable 2011 periods. In 2012, on a year-to-date basis, our average net selling price for the BLU-U® decreased to \$7,044 from \$7,574 in 2011. The decrease in our average selling price from the prior year is a result of incentive discounting. Our BLU-U® evaluation program allows customers to take delivery for a limited number of BLU-U® units for a period of up to four months for private practitioners and up to one year for hospital clinics, before we require a purchase decision. At June 30, 2012, there were approximately 37 units in the field pursuant to this evaluation program, compared to 48 units in the field at December 31, 2011. The units are classified as inventory in the financial statements and are being amortized during the evaluation period to cost of goods sold using an estimated life for the equipment of three years. In addition, the Company offers active customers who own an out-of-warranty, non-current version of the BLU-U®, the opportunity to purchase our latest model at a discounted price with the return of the older unit.

The increase in our total product revenues for the three and six-month periods ended June 30, 2012, compared to the comparable 2011 periods, result primarily from increased Kerastick® and BLU-U® revenues in the United States. We have to continue to demonstrate the clinical value of our unique therapy, and the related product benefits as compared to other well-established conventional therapies, in order for the medical community to accept our products on a large scale. We are aware that physicians are using Levulan® with the BLU-U® using short incubation times, and with light devices manufactured by other companies, and for uses other than our FDA-approved use. While we are not permitted to market our products for so-called off-label uses, we believe that these activities are positively affecting the sales of our products. Additionally, in 2011, we initiated two Phase 2 clinical trials to study broad area, short incubation methods, which, if successful, would encourage us to conduct further studies which, following additional larger Phase 3 clinical studies, could lead to enhancements to our current product label and allow us to market our therapy under a treatment method being adopted by the medical community.

During 2012, our revenues in the United States grew as a result of increased demand for our Levulan® Kerastick® and our BLU-U®. With respect to Kerastick® prices, we announced a price increase in the fourth quarter of 2011, which became effective January 1, 2012. We intend to announce a price increase each year in the fourth quarter, which will become effective on January 1 of the following year. This strategy is likely to have a positive impact on sales volumes in the fourth quarter of each year. Although we expect continued growth in revenues, we are susceptible to the uncertain economic conditions, particularly with our Canadian customer base where our product lacks reimbursement, and to increased competition, particularly from Medicis Pharmaceutical Corporation, who in December 2011 acquired Aldara®, a topical AK product, and Zyclara®, used to treat precancerous skin growths related to sun overexposure, and Leo Pharma, who in January 2012 received FDA approval for Picato® Gel, a topical product, to treat AKs on the face and scalp and on the extremities. Also, Galderma, S.A., a large dermatology company, holds a non-exclusive license from us to Metvixia®, which was transferred to Galderma by PhotoCure ASA, our original licensee. This product received FDA approval for treatment of AKs in July 2004 and it is directly competitive with our Levulan® Kerastick® product. Metvixia® is commercially available in the U.S.; however, to our knowledge, product revenues have not been significant to date. Also, in June 2011, PhotoCure announced the commercial launch of an ALA ester-based product, Allumera®, as a cosmetic, which could cause disruption in the marketplace.

Our ability to maintain profitability on a quarterly basis may be affected by fluctuations in the demand for our products caused by both seasonal changes, such as when patient visits slow during summer months resulting in historically lower third quarter volumes as compared to the other quarters of the year, and the timing of pricing changes, which may impact the purchasing patterns of our customers.

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Also see the section entitled Risk Factors We May Not Maintain Profitability On A Quarterly Basis Unless We Can Successfully Market And Sell Higher Quantities Of Our Products.

Table of Contents

Cost of Product Revenues Cost of product revenues for the three and six-month periods ended June 30, 2012 were \$1,778,000 and \$3,848,000 as compared to \$1,471,000 and \$3,102,000 in the comparable periods in 2011. A summary of the components of cost of product revenues and royalties is provided below:

	Three months ended June 30,		
	2012	2011	Increase/ (Decrease)
Levulan® Kerastick® Cost of Product Revenues and Royalties			
Direct and indirect Levulan® Kerastick® Product Costs	\$ 790,000	\$ 670,000	\$ 120,000
Royalty and supply fees (1)	444,000	363,000	81,000
 Subtotal Levulan® Kerastick® Cost of Product Revenues and Royalties	 \$ 1,234,000	 \$ 1,033,000	 \$ 201,000
BLU-U® Cost of Product Revenues			
Direct BLU-U® Product Costs	\$ 277,000	\$ 225,000	\$ 52,000
Other BLU-U® Product Costs including internal costs assigned to support products; as well as, costs incurred to ship, install and service the BLU-U® in physicians' offices	267,000	213,000	54,000
 Subtotal BLU-U® Cost of Product Revenues	 \$ 544,000	 \$ 438,000	 \$ 106,000
TOTAL COST OF PRODUCT REVENUES AND ROYALTIES	\$ 1,778,000	\$ 1,471,000	\$ 307,000

	Six months ended June 30,		
	2012	2011	Increase/ (Decrease)
Levulan® Kerastick® Cost of Product Revenues and Royalties			
Direct and indirect Levulan® Kerastick® Product Costs	\$ 1,667,000	\$ 1,466,000	\$ 201,000
Royalty and supply fees (1)	944,000	774,000	170,000
 Subtotal Levulan® Kerastick® Cost of Product Revenues and Royalties	 \$ 2,611,000	 \$ 2,240,000	 \$ 371,000
BLU-U® Cost of Product Revenues			
Direct BLU-U® Product Costs	\$ 756,000	\$ 482,000	\$ 274,000
Other BLU-U® Product Costs including internal costs assigned to support products; as well as, costs incurred to ship, install and service the BLU-U® in physicians' offices	\$ 481,000	380,000	101,000
 Subtotal BLU-U® Cost of Product Revenues	 \$ 1,237,000	 \$ 862,000	 \$ 375,000
TOTAL COST OF PRODUCT REVENUES AND ROYALTIES	\$ 3,848,000	\$ 3,102,000	\$ 746,000

- 1) Royalty and supply fees reflect amounts paid to our licensor, PARTEQ, and amortization of an upfront fee and royalties paid to Draxis Health Inc. on sales of Levulan® Kerastick® in Canada.

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Margins Total product margins for the three and six-month periods ended June 30, 2012 were \$9,948,000 and \$21,299,000, respectively, as compared to \$8,200,000 and \$17,551,000 for the comparable 2011 periods, as shown below:

	Three months ended June 30,				
	2012		2011		Increase/ (Decrease)
Levulan® Kerastick® gross margin	\$ 10,012,000	89%	\$ 8,186,000	89%	\$ 1,826,000
BLU-U® gross margin	(64,000)	(13)%	14,000	3%	(78,000)
Total gross margin	\$ 9,948,000	85%	\$ 8,200,000	85%	\$ 1,748,000

	Six months ended June 30,				
	2012		2011		Increase/ (Decrease)
Levulan® Kerastick® gross margin	\$ 21,249,000	89%	\$ 17,473,000	89%	\$ 3,776,000
BLU-U® gross margin	50,000	4%	78,000	8%	(28,000)
Total gross margin	\$ 21,299,000	85%	\$ 17,551,000	85%	\$ 3,748,000

Table of Contents

Kerastick® gross margins for the three and six-month periods ended June 30, 2012 and 2011 were 89% for all periods.

Our long-term goal is to achieve higher gross margins on Kerastick® sales. We believe that we can achieve improved gross margins on our Kerastick® from further volume growth and price increases in the United States.

BLU-U® margins for the three and six-month periods ended June 30, 2012 were (13%) and 4%, respectively, as compared to 3% and 8% in the comparable 2011 periods. The decrease in gross margin percentage is a result of a decrease in our average selling price, partially offset by an increase in sales volumes. It is important for us to sell BLU-U® units in an effort to increase Kerastick® sales volumes, and accordingly, we may sell BLU-U® units at low profit margins.

Research and Development Costs Research and development costs for the three and six-month periods ended June 30, 2012 were \$2,207,000 and \$4,258,000 as compared to \$1,109,000 and \$2,432,000 in the comparable 2011 periods. The increase in 2012 compared to 2011 was due primarily to increased spending related to 2 clinical trials, which were initiated in late 2011, as further described in the following paragraph. In addition, we are exploring potential new formulations for Levulan® as part of our product life cycle management activities.

A DUSA-sponsored Phase 2 clinical trial designed to study the broad area application and short drug incubation, or BASDI, method of using the Levulan® Kerastick® was initiated during the fourth quarter of 2011, and is being carried out at 13 clinical trial sites. Two hundred thirty-five (235) study subjects were enrolled in this trial, which has been closed to further accrual. The protocol objectives are to compare the effect of various incubation times (1, 2 or 3 hours of broad area application), versus a 2 hour spot incubation on the safety and efficacy of Levulan® plus BLU-U® PDT versus vehicle plus BLU-U® for the treatment of multiple actinic keratoses of the face or scalp and to investigate the potential for reduction in AK occurrence in the treatment areas during a follow-up period of up to 6 months. We expect that preliminary results of this trial will be available by the end of 2012. In addition to the BASDI clinical trial a pilot DUSA-sponsored clinical trial designed to study a BASDI method of using the Levulan® Kerastick® for the treatment of AKs on upper extremities was initiated during the fourth quarter of 2011 at 3 clinical trial sites. Seventy (70) subjects were enrolled in this study, which has been closed to further accrual. The objective of the study is to compare the safety and efficacy of Levulan® Kerastick® plus BLU-U® PDT versus vehicle plus BLU-U® PDT on AKs of the upper extremities, and to evaluate the effect of occlusive dressing versus no occlusive dressing during the 3 hour incubation period. We expect that the preliminary results of this study will be available by the end of the third quarter of 2012. Due to these studies, we expect research and development costs for 2012 to be increased from 2011 levels. We expect that the total cost of these trials will be approximately \$2.8 million over the course of the trials.

Marketing and Sales Costs Marketing and sales costs for the three and six-month periods ended June 30, 2012 were \$4,001,000 and \$8,