RIBAPHARM INC
Form 10-Q
May 28, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **March 31, 2002**

OR

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

Commission File Number: 1-31294

RIBAPHARM INC.

(Exact name of registrant as specified in its charter)

Delaware	95-4805655
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3300 Hyland Avenue
Costa Mesa, California 92626
(Address of principal executive offices)
(Zip Code)

(714) 427-6236
(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 ¨ No x*

* Registrant became subject to the filing requirements on April 11, 2002.

The number of outstanding shares of the registrant s Common Stock, $.01 par value, as of May 20, 2002 was 150,000,000.

RIBAPHARM INC.

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RIBAPHARM INC.
CONDENSED BALANCE SHEETS
December 31, 2001 and March 31, 2002
(unaudited, in thousands, except per share data)

	December 31, 2001	March 31, 2002	Pro forma March 31, 2002
ASSETS			
Current Assets:			
Receivable from Schering-Plough	$ 16,228	$ 16,228	$ 16,228
Total current assets	16,228	16,228	16,228
Property, plant and equipment, net	10,406	10,354	10,354
	$ 26,634	$ 26,582	$ 26,582
LIABILITIES AND STOCKHOLDER S EQUITY			
Current Liabilities:			
Trade payables	$ 1,069	$ 24	$ 24
Accrued liabilities	4,346	3,014	3,014
Total current liabilities	5,415	3,038	3,038
6½% subordinated notes due 2008			525,000
Commitments and contingencies			
Stockholder s equity (deficit);			
Preferred stock, $0.01 par value; 10,000 shares authorized; none issued and outstanding			
Common stock $.01 par value; 400,000 shares authorized; 150,000 shares issued and outstanding at March 31, 2002 and December 31, 2001	1,500	1,500	1,500
Advances due from ICN	(188,017)	(215,667)	(215,667)
Receivable from ICN			(525,000)
Retained earnings	207,736	237,711	237,711
Total stockholder s equity (deficit)	21,219	23,544	(501,456)
	$ 26,634	$ 26,582	$ 26,582

The accompanying notes are an integral part of these condensed financial statements.

RIBAPHARM INC.
CONDENSED STATEMENTS OF INCOME
For the three months ended March 31, 2001 and 2002
(unaudited, in thousands, except per share data)

	Three Months Ended March 31,	
	2001	**2002**
Revenues	$ 29,234	$ 57,001
Operating expenses:		
Research and development	5,493	6,577
General and administrative	604	2,077
Total operating expenses	6,097	8,654
Income before provision for income taxes	23,137	48,347
Provision for income taxes	8,329	18,372
Net income	$ 14,808	$ 29,975
Basic and diluted earnings per share	$ 0.10	$ 0.20
Shares used in per share computation	150,000	150,000

The accompanying notes are an integral part of these condensed financial statements.

RIBAPHARM INC.
CONDENSED STATEMENTS OF CASH FLOWS
For the three months ended March 31, 2001 and 2002
(unaudited, in thousands)

	Three Months Ended March 31,	
	2001	**2002**
Cash flows from operating activities:		
Net income	$ 14,808	$ 29,975
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	537	691
Schering-Plough receivable	(1,000)	
Change in royalty receivable transferred to ICN	6,842	(2,546)
Change in trade payables and accrued liabilities	(472)	(2,377)
Net cash provided by operating activities	20,715	25,743
Cash flows from investing activities:		
Capital expenditures	(2,612)	(639)
Net cash used in investing activities	(2,612)	(639)
Cash flows from financing activities:		
Cash payments to ICN, net	(18,103)	(25,104)
Net cash used in financing activities	(18,103)	(25,104)
Net increase in cash and cash equivalents		
Cash and cash equivalents at beginning of period		
Cash and cash equivalents at end of period	$	$

The accompanying notes are an integral part of these condensed financial statements.

MANAGEMENT S STATEMENT REGARDING UNAUDITED FINANCIAL STATEMENTS

The condensed financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared on the basis of accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The results of operations presented herein are not necessarily indicative of the results to be expected for a full year. The Company believes that all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation of the interim periods presented are included and that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Registration Statement on Form S-1 (SEC File No. 333-39350) as amended, filed with the SEC on April 11, 2002.

RIBAPHARM INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
March 31, 2002
(unaudited)

1. Description of Business and Basis of Presentation:

Until April 17, 2002, Ribapharm Inc. (the Company or Ribapharm) was a wholly owned subsidiary of ICN Pharmaceuticals, Inc. (ICN). The Company seeks to discover, develop, acquire and commercialize innovative products for the treatment of significant unmet medical needs, principally in the antiviral and anticancer areas. The Company s primary product, ribavirin, is an antiviral drug that was licensed to Schering-Plough Ltd. (Schering-Plough) for the treatment of chronic hepatitis C (HCV) in combination with Schering-Plough s interferon alfa-2b or pegylated interferon alfa-2b. All of the Company s revenue is currently derived from this licensing agreement. The accompanying financial statements are derived from the historical books and records of ICN and present the assets and liabilities, results of operations and cash flows applicable to the Company.

On April 10, 2002, Ribapharm effected a recapitalization of its Common Stock in the form of a 1,500,000 for 1.0 stock split. The certificate of incorporation provides for authorized capital stock of 410,000,000 shares, including 400,000,000 shares of common stock, $.01 par value per share (the Common Stock), and 10,000,000 shares of preferred stock, $.01 par value per share. No preferred stock is outstanding. The financial statements give effect to the recapitalization and stock split, applied retroactively to all periods presented.

On April 17 and 26, 2002, ICN completed an underwritten public offering in the aggregate of 29,900,000 shares of Common Stock, (the Offering) representing 19.93% of the total outstanding Common Stock of 150,000,000 shares. In connection with the Offering, ICN received net cash proceeds of $278,070,000. The Company received no proceeds from the Offering. Additionally, upon consummation of the Offering, the advances due from ICN were transferred as a component of permanent equity. Ribapharm was not repaid any of the advances due from ICN upon completion of the Offering.

The balance sheets have been prepared using the historical basis of accounting and include all of the assets and liabilities specifically identifiable to the Company. The statements of income include all revenue and costs attributable to the Company, including a corporate allocation of costs between the Company and ICN of shared services (including legal, finance, corporate development, information systems and corporate office expenses). These costs are allocated to the Company on a basis that is considered by management to reflect most fairly or reasonably the utilization of services provided to or the benefit obtained by the Company, such as the square footage, headcount, or actual utilization. It is not practicable to determine the costs specifically attributable to either ICN or Ribapharm with respect to the US Attorney investigation or the SEC litigation, see Note 7. Additionally, allocation methods of these costs based upon revenue, net income, assets, equity or headcount are not reflective of the nature of the costs incurred. Therefore, ICN and Ribapharm used a joint responsibility approach in allocating these costs such that 50% of the costs, including any reserve for settlement, are allocated to each of ICN and Ribapharm. Management believes the methods used to allocate these amounts are reasonable. However, the financial information included herein does not necessarily reflect what the financial position or results of operation would have been had the Company operated as a stand-alone public entity during the periods covered, and may not be indicative of future results of operations or financial position. For the quarters ended March 31, 2002 and 2001 allocated costs amounted to $1,459,000, and $494,000 respectively, and are included in operating expenses. The details of the allocation for the quarters ended March 31, 2002 and 2001, were as follows (in thousands):

	March 31,	
	2001	2002
Legal expenses and professional fees	$ 72	$ 1,156
Facility and central service costs	408	289
Information systems	14	14
	$ 494	$ 1,459

For the quarters ended March 31, 2002 and 2001 the legal expenses and professional fees allocation includes amounts related to the United States Attorney investigation and SEC litigation of $573,000 and $59,000, respectively.

RIBAPHARM INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS (continued)
March 31, 2002
(unaudited)

2. Summary of Significant Accounting Policies:

Revenue Recognition: The Company earns royalties as a result of the sale of product rights and technology to third parties. Royalty revenue is earned at the time the products subject to the royalty are sold by the third party. The Company recognizes as revenue up-front nonrefundable fees associated with royalty and license agreements when all performance obligations under the agreements are completed. Milestone payments received, if any, related to scientific achievement are recognized as revenue when the milestone is accomplished by the third party.

Research and Development: Research and development costs are expensed as incurred.

Income Taxes: The Company s operations are included in the consolidated ICN tax returns. Income tax provisions and benefits have been calculated on a separate return basis for federal income tax purposes and based upon ICN s worldwide apportionment rate for the State of California. The apportionment rate was 3% for the three months ended March 31, 2002 and 1% for the three months ended March 31, 2001. Deferred income taxes are calculated using the estimated future tax effects or differences between financial statement carrying amounts and the tax bases of assets and liabilities. The Company and ICN are parties to a tax sharing agreement

Concentration of Credit Risk: Financial instruments that subject the Company to concentrations of credit risk consist principally of accounts receivable. The Company performs an ongoing credit evaluation of its customers financial condition and generally does not require collateral to secure accounts receivable. The Company s exposure to credit risk associated with nonpayment is affected principally by conditions or occurrences within its primary customer. The Company historically has not experienced losses relating to accounts receivable from its primary customer. All revenues for the three months ended March 31, 2002 and 2001 were derived from one customer.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Earnings Per Share: Earnings per share has been calculated for all periods presented using the 150,000,000 shares of Common Stock outstanding after the completion of the recapitalization and stock split, which occurred on April 10, 2002.

Reclassifications: Certain prior period amounts have been reclassified to conform to current period presentation, with no effect on net income or stockholder s equity.

3. Agreement with Schering-Plough:

On July 28, 1995, ICN entered into an Exclusive License and Supply Agreement (the License Agreement) with Schering-Plough. Under the License Agreement, Schering-Plough licensed all oral forms of ribavirin for the treatment of HCV in combination with Schering-Plough s interferon alfa-2b. The License Agreement provided ICN an initial non-refundable payment and future royalty payments from sales of ribavirin by Schering-Plough, including certain minimum royalty rates. As part of the initial License Agreement, ICN retained the right to co-market ribavirin capsules in the European Union under its trademark Virazole. In 1998, ICN and the Company received a one-time payment of $16,500,000 from Schering-Plough of which the Company received $13,467,000 for settlement of past royalties due on samples and free product distributed by Schering-Plough ($8,467,000) and forgiveness of a $5,000,000 obligation to them. In addition, the Company gave up the right to co-market in the European Union in exchange for an increase in worldwide royalty rates.

As part of ICN s contribution of Ribapharm s assets, on August 7, 2000, ICN contributed to Ribapharm its rights under the License Agreement subject to the consent of third parties, which consents became effective on April 17, 2002.

Schering-Plough has informed ICN that it believes royalties paid under the ribavirin license agreement should not include royalties on products distributed as part of an indigent patient marketing program. Schering-Plough claims that because it receives no revenue from products given to indigent patients, it is not required to pay royalties on these products under the ribavirin license agreement. The Company and ICN do not agree with Schering-Plough s interpretation of the agreement. However, in August 2001,

RIBAPHARM INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS (continued)
March 31, 2002
(unaudited)

Schering-Plough withheld approximately $11,628,000 from its royalty payment relating to the second quarter of 2001. The amount withheld was purportedly intended by Schering-Plough to be a retroactive adjustment of royalties previously paid to ICN through the third quarter of 2000 on products distributed as part of this indigent patient marketing program. Since the beginning of the fourth quarter of 2000, Schering-Plough is withholding on a current basis all royalty payments purportedly related to this indigent patient marketing program. The Company recognized the $11,628,000 of withheld royalty payments for the retroactive adjustment and $3,050,000 of royalty payments withheld for the fourth quarter of 2000 and the first quarter of 2001 as income. ICN has allocated this portion and other amounts of the royalty receivable to Ribapharm. As of March 31, 2002, the Company has not established a reserve for this receivable because, in the opinion of the Company s management, collectibility is reasonably assured. Since the second quarter of 2001, the Company no longer recognizes any of these withheld royalty payments as income as the Company can no longer determine such amounts due to a lack of information from Schering-Plough. ICN and the Company intend to arbitrate this royalty payment dispute to collect these royalties and prevent Schering-Plough from withholding royalty payments on sales under the indigent patient marketing program in the future. The parties have selected an arbitrator and arbitration is scheduled to begin in September 2002. If ICN and the Company do not succeed in this alternative dispute resolution process, the Company may have to write off all or a portion of this receivable. If ICN and the Company do succeed, the Company will be entitled to receive the royalty payments on these indigent patient sales withheld by Schering-Plough.

In April 2002 Schering-Plough asserted a counterclaim against ICN and the Company in this arbitration based on ICN s alleged failure to assist Schering-Plough in securing certain distribution rights in Egypt. ICN and the Company have objected to Schering-Plough s counterclaim as procedurally improper and unduly vague. ICN and the Company intend to vigorously contest this counterclaim should the arbitrator permit it to proceed.

In November 2000, the Company and ICN entered into an agreement to provide Schering-Plough with certain rights to license various products the Company may develop. Under the terms of the agreement, Schering-Plough has the option to exclusively license on a worldwide basis up to three compounds that the Company may develop for the treatment of hepatitis C on terms specified in the agreement. The option does not apply to Levovirin or Viramidine. The option is exercisable as to a particular compound at any time prior to the start of Phase II clinical studies for that compound. Once it exercises the option with respect to a compound, Schering-Plough is required to take over all developmental costs and responsibility for regulatory approval for that compound. Under the agreement, Ribapharm will receive royalty revenues based on the sales of licensed products. These rates will increase upon the achievement of different milestones and may be reduced upon the expiration of some of the Company s patent rights.

Under the terms of the agreement, ICN and the Company also granted Schering-Plough rights of first/last refusal to license compounds relating to the treatment of infectious diseases (other than hepatitis C) or cancer or other oncology indications as well as rights of first/last refusal with respect to Levovirin and Viramidine (collectively, the Refusal Rights). Under the terms of the Refusal Rights, if the Company intends to offer a license or other rights with respect to any of these compounds to a third party, the Company is required to notify Schering-Plough. At Schering-Plough s request, the Company is required to negotiate in good faith with Schering-Plough on an exclusive basis the terms of a mutually acceptable exclusive worldwide license or other form of agreement on commercial terms to be mutually agreed upon. If the Company cannot reach an agreement with Schering-Plough, the Company is permitted to negotiate a license agreement or other arrangement with a third party. Prior to entering into any final arrangement with the third party, the Company is required to offer substantially similar terms to Schering-Plough, which terms Schering-Plough has the right to match.

If Schering-Plough does not exercise its option or Refusal Rights as to a particular compound, the Company may continue to develop that compound or license that compound to other third parties. The agreement with Schering-Plough will terminate on the later of November 14, 2012 or the termination of the 1995 license agreement with Schering-Plough. The agreement was entered into as part of the resolution of claims asserted by Schering-Plough against the Company, including claims regarding the Company s alleged improper hiring of former Schering-Plough research and development personnel and claims that ICN and the Company were not permitted to conduct hepatitis C research.

RIBAPHARM INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS (continued)
March 31, 2002
(unaudited)

4. Related Party Transactions:

At the time of the Offering, Ribapharm and ICN entered into an affiliation and distribution agreement, which places restrictions on Ribapharm s ability to issue capital stock to ensure that Ribapharm remains part of ICN s consolidated group for tax purposes; a management services and facilities agreement, which details ICN s agreement to provide Ribapharm with interim administrative and corporate services; a lease agreement, which provides Ribapharm a long-term lease in ICN s Costa Mesa facility; a confidentiality agreement, which provides that Ribapharm and ICN will not disclose to third parties confidential and proprietary information concerning each other; a registration rights agreement, which grants ICN rights to require Ribapharm to register shares of Ribapharm common stock owned by ICN; and a tax sharing agreement, which governs Ribapharm s commitment to remain part of ICN s consolidated tax group.

The lease agreement with ICN provides for a lease payment of $5,000,000 per year, plus consumer price index increases, for five years, with a five year option to renew. The lease will be accounted for as an operating lease by Ribapharm. In connection with the lease agreement, Ribapharm will pay, in addition to the lease payment, ICN for its pro rata portion of common charges for the building.

Prior to the Offering at the end of each quarter, all amounts receivable from Schering-Plough relating to the License Agreement were transferred to ICN. Additionally, all excess cash remaining after payment by Ribapharm of its costs were transferred to ICN. The royalty payment for sales of ribavirin in the second quarter of 2002 is payable in late August 2002. This royalty payment will be divided between ICN and the Company on a pro-rata basis based on April 17, 2002, the closing date of the Offering. The Company will retain all subsequent royalty payments.

Following is a summary of transactions between Ribapharm and ICN for each of the three months ended March 31, 2002 and 2001 (in thousands):

	March 31,	
	2001	2002
Allocation of costs of shared services (Note 1)	$ 494	$ 1,459
Allocation of current income tax expense	8,329	18,372
Increase (decrease) in royalty receivable transferred to ICN	6,842	(2,546)
Cash transferred to ICN	(26,926)	(44,935)
Total	$ (11,261)	$ (27,650)

5. Detail of Certain Accounts (in thousands):

	December 31, 2001	March 31, 2002
Property, plant and equipment, net:		