DUSA PHARMACEUTICALS INC
Form 10-Q
May 08, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended: March 31, 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)

New Jersey	22-3103129
(State of Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
25 Upton Drive, Wilmington, MA	01887
(Address of Principal Executive Offices)	(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 þ 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 þ 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 þ Non-accelerated filer ¨ Smaller reporting company

¨

(Do not check if a 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 þ

As of May 4, 2012, the registrant had 24,932,087 shares of Common Stock, no par value per share, outstanding.

Table of Contents

DUSA PHARMACEUTICALS, INC.

TABLE OF CONTENTS TO FORM 10-Q

EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

PART I.

ITEM 1. FINANCIAL STATEMENTS

DUSA PHARMACEUTICALS, INC.

CONSOLIDATED BALANCE SHEETS

	March 31 2012	December 31 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 25,236,307	$ 24,423,682
Marketable securities, at fair value	3,784,069	3,791,942
Accounts receivable, net of allowance for doubtful accounts of $45,000 and $50,000 in 2012 and 2011, respectively	3,353,226	3,729,303
Inventory	3,222,775	2,823,173
Prepaid and other current assets	1,220,951	1,380,763
Current assets of discontinued operations		38,671
TOTAL CURRENT ASSETS	36,817,328	36,187,534
Restricted cash	175,921	175,810
Property, plant and equipment, net	1,836,858	1,601,101
Deferred charges and other assets	85,489	57,833
TOTAL ASSETS	$ 38,915,596	$ 38,022,278
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,332,175	$ 803,639
Accrued compensation	546,735	2,351,342
Other accrued expenses	3,368,993	2,459,562
Current liabilities of discontinued operations	319,598	851,775
TOTAL CURRENT LIABILITIES	5,567,501	6,466,318
Deferred revenues	897,101	900,769
Warrant liability	4,140,569	2,216,763
Other liabilities	150,650	157,238
TOTAL LIABILITIES	10,755,821	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: 24,932,087 and 24,649,614 shares of common stock, no par, at March 31, 2012 and December 31, 2011, respectively	151,758,788	151,985,930
Additional paid-in capital	11,056,669	10,606,654
Accumulated deficit	(134,674,120)	(134,336,998)
Accumulated other comprehensive income	18,438	25,604
TOTAL SHAREHOLDERS EQUITY	28,159,775	28,281,190
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 38,915,596	$ 38,022,278

See the accompanying Notes to the Consolidated Financial Statements.

Table of Contents

DUSA PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2012	**2011**
Product revenues	$ 13,420,685	$ 10,981,689
Cost of product revenues	2,069,868	1,630,564
GROSS MARGIN	11,350,817	9,351,125
Operating costs		
Research and development	2,050,763	1,323,644
Marketing and sales	4,633,579	3,973,224
General and administrative	3,082,770	2,452,747
TOTAL OPERATING COSTS	9,767,112	7,749,615
INCOME FROM OPERATIONS	1,583,705	1,601,510
Other income	2,979	16,454
Loss on change in fair value of warrants	(1,923,806)	(2,188,933)
LOSS FROM CONTINUING OPERATIONS	(337,122)	(570,969)
LOSS FROM DISCONTINUED OPERATIONS		(33,931)
NET LOSS	$ (337,122)	$ (604,900)
NET LOSS PER SHARE BASIC AND DILUTED		
CONTINUING OPERATIONS	$ (0.01)	$ (0.02)
DISCONTINUED OPERATIONS		
NET LOSS PER SHARE	$ (0.01)	$ (0.02)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	24,719,290	24,283,398

See the accompanying Notes to the Consolidated Financial Statements.

Table of Contents

DUSA PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Three Months Ended March 31,	
	2012	**2011**
NET LOSS	$ (337,122)	$ (604,900)
Change in net unrealized gains on marketable securities available-for-sale	(7,166)	(23,636)
COMPREHENSIVE LOSS	$ (344,288)	$ (628,536)

See the accompanying Notes to the Consolidated Financial Statements.

Table of Contents

DUSA PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2012	**2011**
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES		
Net loss	$ (337,122)	$ (604,900)
Less: Loss from discontinued operations		33,931
Net loss from continuing operations	(337,122)	(570,969)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Accretion of premiums and discounts on marketable securities	707	(4,840)
Share-based compensation	450,015	196,649
Depreciation and amortization	162,535	106,284
Loss on change in fair value of warrants	1,923,806	2,188,933
Deferred revenues recognized	(3,668)	(119,597)
Changes in other assets and liabilities impacting cash flows from operations:		
Accounts receivable	376,077	587,283
Inventory	(399,602)	(393,121)
Prepaids and other assets	132,156	155,962
Accounts payable, accrued compensation and other accrued expenses	(582,166)	(669,043)
Other liabilities	(6,588)	(10,155)
NET CASH PROVIDED BY OPERATING ACTIVITIES FROM CONTINUING OPERATIONS	1,716,150	1,467,386
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES FROM DISCONTINUED OPERATIONS	(493,506)	112,196
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,222,644	1,579,582
CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES		
Purchases of marketable securities		(1,499,337)
Proceeds from maturities and sales of marketable securities		3,650,000
Restricted cash	(111)	(275)
Purchases of property, plant and equipment	(182,766)	(75,611)
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(182,877)	2,074,777
CASH FLOWS USED IN FINANCING ACTIVITIES		
Proceeds from exercise of options	236,346	126,508
Settlements of restricted stock for tax withholding obligations	(463,488)	(191,020)
NET CASH USED IN FINANCING ACTIVITIES	(227,142)	(64,512)
NET INCREASE IN CASH AND CASH EQUIVALENTS	812,625	3,589,847
Net cash provided by (used in) discontinued operations	493,506	(112,196)
Increase in cash and cash equivalents from continuing operations	1,306,131	3,477,651
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	24,423,682	8,884,402
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 25,236,307	$ 12,474,249

Supplemental disclosures of non-cash investing activities:				
Accrued capital expenditures	$	215,526	$	

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 March 31, 2012, and the Consolidated Statements of Operations, Comprehensive Loss and Cash Flows for the three-month periods ended March 31, 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 condensed 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 March 31, 2012 and December 31, 2011 consisted primarily of cash and cash equivalents, accounts receivable, marketable securities, accounts payable, and 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.

7

Table of Contents

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

	Fair Value Measurements at March 31, 2012			
	Carrying Value	(Level 1)	(Level 2)	(Level 3)
Assets				
Cash and cash equivalents	$ 25,236,000	$ 25,236,000		
United States government-backed securities	3,563,000		$ 3,563,000	
Certificate of Deposit Restricted Cash	176,000	176,000		
Corporate debt securities	221,000		221,000	
Total assets at fair value	$ 29,196,000	$ 25,412,000	$ 3,784,000	
Liabilities				
Warrant liability	$ 4,141,000			$ 4,141,000
Total liabilities at fair value	$ 4,141,000	$	$	$ 4,141,000

	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 financial instruments at March 31, 2012 compared to December 31, 2011 and determined that there were no significant transfers between levels in three months ended March 31, 2012.

The table below includes a rollforward of the balance sheet amounts for the three-month periods ended March 31, 2012 and 2011 for the warrant liability, which is classified as Level 3.

Table of Contents

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Three-Month Period Ended March 31, 2012

	Fair Value at January 1, 2012	Total Unrealized Loss Recognized in Statement of Operations	Purchases, Sales, Issuances, Settlements, Net	Transfers In and/or Our Out of Level 3	Fair Value at March 31 2012	Change in Unrealized Loss in 2012
Warrant Liability	$ 2,217,000	$ 1,924,000	$	$	$ 4,141,000	$ (1,924,000)

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Three-Month Period Ended March 31, 2011

	Fair Value at January 1, 2011	Total Unrealized Loss Recognized in Statement of Operations	Purchases, Sales, Issuances, Settlements, Net	Transfers In and/or Our Out of Level 3	Fair Value at March 31 2011	Change in Unrealized Loss in 2011
Warrant Liability	$ 1,204,000	$ 2,189,000	$	$	$ 3,393,000	$ (2,189,000)

Marketable Securities

The Company s marketable securities consist of the following:

	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
United States government-backed securities	$ 3,551,000	$ 13,000	$ (1,000)	$ 3,563,000
Corporate securities	215,000	6,000		221,000
Total marketable securities	$ 3,766,000	$ 19,000	$ (1,000)	$ 3,784,000

	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-month periods ended March 31, 2012 and 2011 were $7,000 and $24,000, respectively, which have been recorded in accumulated other comprehensive income, are reported as part of shareholders equity in the Consolidated Balance Sheets and are reported in the Consolidated Statements of Comprehensive Loss. Realized losses on sales of marketable securities were $0 for the three-month periods ended March 31, 2012 and 2011. As of March 31, 2012, current yields range from 0.25% to 4.57% and maturity dates range from June 2012 to January 2013.

Table of Contents

Common Stock Warrants

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 revalued 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. Non-cash losses for the three-month periods ended March 31, 2012 and 2011 were $1,924,000 and $2,189,000, respectively. At March 31, 2012 and December 31, 2011, the aggregate fair value of these warrants was $4,141,000 and $2,217,000, respectively. Assumptions used for the Black-Scholes option-pricing models in determining the fair value as of March 31, 2012 and December 31, 2011 are as follows:

	March 31, 2012	December, 31 2011
Expected volatility	69.3%	61%
Remaining contractual term (years)	1.1	1.3
Risk-free interest rate	0.1%	0.2%
Expected dividend yield	0%	0%
Common stock price	$ 6.26	$ 4.38

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:

	March 31, 2012	December 31, 2011
Finished goods	$ 1,223,000	$ 1,110,000
BLU-U® evaluation units	191,000	225,000
Work in process	239,000	291,000
Raw materials	1,570,000	1,197,000
Total	$ 3,223,000	$ 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 of three years to cost of product revenues to approximate its net realizable value.

5) OTHER ACCRUED EXPENSES

Other accrued expenses consisted of the following:

	March 31, 2012	December 31, 2011
Research and development costs	$ 862,000	$ 323,000
Marketing and sales costs	643,000	249,000
Other product related costs	880,000	918,000
Legal and other professional fees	353,000	363,000
Employee benefits	393,000	368,000
Other expenses	238,000	239,000
Total	$ 3,369,000	$ 2,460,000

Table of Contents

6) SHARE-BASED AWARDS

The weighted-average estimated fair value of stock options granted during the three-month periods ended March 31, 2012 and 2011 was $4.05 and $2.77 per share, respectively, determined using the Black-Scholes option valuation model with the following weighted-average assumptions (annualized percentages):

	Three Months Ended March 31,	
	2012	**2011**
Volatility	78.1%	77.0%
Risk-free interest rate	1.0%	2.4%
Expected dividend yield	0%	0%
Expected life-directors and officers	6.1 years	5.9 years
Expected life-non-officer employees	5.6 years	5.6 years

A summary of stock option activity for the three-month period ended March 31, 2012 follows:

	Number of Options	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (Years)**	**Aggregate Intrinsic Value**
Outstanding, beginning of period	2,811,225	$ 3.97		
Options granted	116,300	$ 6.20		
Options forfeited	(750)	$ 2.20		
Options expired		$		
Options exercised	(98,476)	$ 2.40		
Outstanding, end of period	2,828,299	$ 4.12	3.87	$ 8,367,000
Exercisable, end of period	2,060,401	$ 4.64	3.42	$ 5,649,000
Options vested and expected to vest, end of period	2,754,154	$ 4.12	3.81	$ 8,201,000

At March 31, 2012 total unrecognized estimated compensation cost related to stock options was $1,080,000 which is expected to be recognized over a weighted average period of 2.07 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:

	Three Months Ended March 31,	
	2012	**2011**

Outstanding unvested shares of common stock, beginning of period	901,000	586,000
Shares granted	910,000	450,000
Shares vested	(267,000)	(154,000)
Outstanding, end of period	1,544,000	882,000
Weighted average grant date fair value of shares vested during period	$ 2.60	$ 1.43
Weighted average grant date fair value of shares granted during period	$ 6.20	$ 4.20
Weighted average grant date fair value of unvested shares, end of period	$ 5.00	$ 2.90
Weighted average remaining years to vest	3.27	3.17

At March 31, 2012 total unrecognized estimated compensation cost related to non-vested common shares was $7,018,000, which is expected to be recognized over a weighted average period of 3.27 years.

Table of Contents

7) BASIC AND DILUTED NET LOSS PER SHARE

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

	Three Months Ended March 31,	
	2012	**2011**
Stock options	2,828,000	3,047,000
Warrants	1,145,000	1,145,000
Unvested Shares of common stock	1,544,000	882,000
Total	5,517,000	5,074,000

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-month periods ended March 31, 2012 and 2011:

	Three Months Ended March 31,	
	2012	**2011**
Revenues	$	$ 100,000
Cost of revenues		(129,000)
Gross Margin (1)		(29,000)
Operating Expenses		
Selling, general and administrative		5,000
Total operating expenses		5,000
Loss from discontinued operations	$	$ (34,000)

(1) Historical gross margin disclosures for the Non-PDT Drug Products segment included general corporate overhead allocations of $14,000, for 2011. 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 as of March 31, 2012 and December 31, 2011:

	March 31,	**December 31,**

	2012	2011
Assets from discontinued operations:		
Accounts receivable, net of allowance for doubtful accounts	$	$ 39,000
Total assets from discontinued operations		39,000
Liabilities from discontinued operations:		
Accounts payable	3,000	3,000
Sales returns reserve	189,000	252,000
Deferred revenues	78,000	78,000
Payment due to former Sirius shareholders		250,000
Non-PDT license payable		250,000
Other	50,000	19,000
Total liabilities from discontinued operations	$ 320,000	$ 852,000

Table of Contents

The following is a summary of net cash (used in) provided by operating activities from discontinued operations for the three-month periods ended March 31, 2012 and 2011:

	Three Months Ended March 31,	
	2012	2011
Loss from discontinued operations	$	$ (34,000)
Decrease in assets	39,000	46,000
(Decrease) increase in liabilities	(532,000)	100,000
Net cash (used in) provided by operating activities from discontinued operations	$ (493,000)	$ 112,000

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 March 31, 2012
Sales returns reserve	$ 252,000	$	$ (63,000)	$ 189,000

	Balance at January 1, 2011	Provision	Actual Returns or Credits	Balance at March 31, 2011
Sales returns reserve	$ 125,000	$ 55,000	$ (22,000)	$ 158,000

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 $90,000 and $85,000 for the three-month periods ended March 31, 2012 and 2011, respectively. Future minimum payments under lease arrangements at March 31, 2012 are as follows:

Years Ending December 31,	Operating Lease Obligations
2012	$ 292,000

2013		396,000
2014		367,000
Total	$	1,055,000

The Company has not accrued amounts for any other potential contingencies as of March 31, 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.

Table of Contents

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.

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 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.

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 three months ended March 31, 2012.

RESULTS OF OPERATIONS THREE MONTHS ENDING MARCH 31, 2012 VERSUS MARCH 31, 2011

Revenues Total revenues for the three-month period ended March 31, 2012 were $13,421,000, as compared to $10,982,000 in 2011 and were comprised of the following:

	Three Months Ended March 31,		
	2012	**2011**	**Increase/(Decrease)**
LEVULAN® KERASTICK® PRODUCT REVENUES			
United States	$ 12,614,000	$ 10,194,000	$ 2,420,000
Canada		183,000	(183,000)
Korea		116,000	(116,000)

Subtotal Levulan® Kerastick® product revenues	12,614,000	10,493,000	2,121,000
BLU-U® PRODUCT REVENUES			
United States	807,000	489,000	318,000
TOTAL PRODUCT REVENUES	$ 13,421,000	$ 10,982,000	$ 2,439,000

For the three-month period ended March 31, 2012, total products revenues, comprised of revenues from our Kerastick® and BLU-U® products, were $13,421,000. This represents an increase of $2,439,000, or 22%, over the comparable 2011 total of $10,982,000. The increase in revenues was driven by increased Kerastick® and BLU-U® revenues in the United States.

Table of Contents

For the three-month period ended March 31, 2012, Kerastick® revenues were $12,614,000, representing an increase of $2,121,000, or 20%, over the comparable 2011 total of $10,493,000. Kerastick® unit sales to end-users for the three-month period ended March 31, 2012 were 83,262, all of which were sold in the United States. This represents an increase from 75,213 Kerastick® units sold in the three-month period ended March 31, 2011, including 72,036 sold in the United States, 1,938 sold in Canada, and 1,239 sold in Korea. Our average net selling price for the Kerastick® increased to $151.41 per unit for the three-month period ended March 31, 2012 from $138.73 per unit in 2011. Our average net selling price for the Kerastick® in the prior year includes sales made directly to our end-user customers, as well as sales made to our international distributors. 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-month period ended March 31, 2012, BLU-U® revenues were $807,000, an increase of $318,000, or 65%, compared to the 2011 total of $489,000. 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-month period ended March 31, 2012, there were 114 units sold, as compared to a total of 64 units sold in 2011. Our average net selling price for the BLU-U® decreased to $7,012 for the three-month period ended March 31, 2012 from $7,434 for 2011. The decrease in our average selling price over the prior year is a result of incentive discounting to coincide with the American Academy of Dermatology meeting. 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 March 31, 2012, there were approximately 35 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 3 years. The increase in our total product revenues for the three-month period ended March 31, 2012, compared to the comparable 2011 period, results 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 2 clinical trials to study broad area, short incubation methods, which, if successful, would encourage us to conduct further studies which 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 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 this product is directly competitive with our Levulan® Kerastick® product. Metvixia® is commercially available in the U.S.; however, 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, and the timing of pricing changes, which may impact the purchasing patterns of our customers.

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 and Royalties Cost of product revenues and royalties for the three-month period ended March 31, 2012 were $2,070,000 as compared to $1,631,000 in 2011. A summary of the components of cost of product revenues and royalties is provided below:

	Three Months Ended March 31,		
	2012	**2011**	**Increase**
Levulan® Kerastick® Cost of Product Revenues and Royalties			
Direct and indirect Levulan® Kerastick® Product Costs	$ 878,000	$ 796,000	$ 82,000
Royalty and supply fees (1)	500,000	411,000	89,000
Subtotal Levulan® Kerastick® Cost of Product Revenues and Royalties	1,378,000	1,207,000	171,000
BLU-U® Cost of Product Revenues			
Direct BLU-U® Product Costs	479,000	257,000	222,000
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	213,000	167,000	46,000
Subtotal BLU-U® Cost of Product Revenues	692,000	424,000	268,000
TOTAL COST OF PRODUCT REVENUES AND ROYALTIES	$ 2,070,000	$ 1,631,000	$ 439,000

(1) Royalty and supply fees reflect amounts paid to our licensor, PARTEQ, on sales of Levulan® Kerastick® in Canada.

Margins Total product margins for the three-month period ended March 31, 2012 were $11,351,000, or 85%, as compared to $9,351,000, or 85%, for the comparable 2011 period, as shown below:

	Three Months Ended March 31,					
	2012		**2011**		**Increase**	
Levulan® Kerastick® gross margin	$ 11,237,000	89%	$ 9,286,000	88%	$ 1,951,000	
BLU-U® gross margin	114,000	14%	65,000	13%	49,000	
TOTAL GROSS MARGIN	$ 11,351,000	85%	$ 9,351,000	85%	$ 2,000,000	

Kerastick® gross margins for the three-month period ended March 31, 2012 were 89% compared to 88% for the comparable 2011 period. The margin improvement for 2012 is attributable to increased U.S. sales volumes and an increase in our overall average selling price.

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-month period ended March 31, 2012 were 14% compared to 13% for the comparable 2011 period. The increase in gross margin percentage is a result of increased sales volumes, partially offset by a decrease in our average selling price. 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-month period ended March 31, 2012 were $2,051,000 as compared to $1,324,000 in the comparable 2011 period. The increase in 2012 compared to 2011 was due primarily to increased spending related to the initiation of 2 clinical trials 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.

An exploratory DUSA-sponsored Phase 2 clinical trial designed to study the broad area application and/or 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 have been enrolled in this trial, which is now closed to further accrual. The protocol objectives are to compare the effect of various incubation times (1, 2 or 3 hours), and spot versus broad area application method, 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. We expect that preliminary results of this trial will be available by the end of 2012. In addition to the BASDI clinical trial for the treatment of AKs of the face and scalp, 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-one (71) subjects have been enrolled in this study and it is now closed to further accrual. The

Table of Contents

objective of the study is to determine and compare the safety and efficacy of ALA PDT versus vehicle PDT on AKs of the upper extremities, and to evaluate the effect of occlusion on the safety and efficacy of ALA PDT, using blue light after a 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-month period ended March 31, 2012 were $4,634,000 as compared to $3,973,000 for the comparable 2011 period. These costs consisted primarily of expenses such as salaries and benefits for the marketing and sales staff, commissions, and related support expenses such as travel, and telephone, totaling $3,291,000 for the three-month period ended March 31, 2012, compared to $2,590,000 in the comparable 2011 period. The increase in spending in 2012 in this category is primarily due to increased headcount. The remaining expenses consisted of tradeshows, miscellaneous marketing and outside consultants totaling $1,343,000 for the three-month period ended March 31, 2012, compared to $1,383,000 for the comparable 2011 period. The decrease in this category is due primarily to a decrease in expenditures related to promotional activities. We expect marketing and sales costs for the full year 2012 to increase from 2011 levels, but to decrease as a percentage of revenues.

General and Administrative Costs General and administrative costs were $3,083,000 for the three-month period ended March 31, 2012 as compared to $2,453,000 for the comparable prior year period. The increase is mainly attributable to compensation related charges. General and administrative expenses are highly dependent on our legal and other professional fees, which can vary significantly from period to period. For the full year 2012, we expect general and administrative costs to increase compared with 2011, but to decrease as a percentage of revenues.

Loss on Change in Fair Value of Warrants The warrants issued to investors in connection with the October 29, 2007 private placement were recorded initially at fair value and are marked to market each reporting period. The increase in the liability during the three-month periods ended March 31, 2012 and 2011 was $1,924,000 and $2,189,000, respectively, which resulted in non-cash losses in the respective periods. The increases in fair value of the warrants are primarily due to increases in our stock price, offset by a decreasing term to expiration. The exercise price of the warrants is $2.85 per share and the warrants expire in April 2013.

Other Income, Net Other income for the three-month period ended March 31, 2012 decreased to $3,000, as compared $16,000 in the comparable 2011 period. The decrease reflects a general decrease in interest rates over that timeframe.

Loss from Discontinued Operations Loss from discontinued operations was $0 and $34,000 during the three-month periods ended March 31, 2012 and 2011, respectively. Discontinued operations reflect the results of our historically designated Non-PDT segment. See Note 8 in the Notes to the Consolidated Financial Statements for further discussion.

Net Loss We reported a net loss of $337,000, or $0.01 per share, for the three-month period ended March 31, 2012, as compared to a net loss of $605,000, or $0.02 per share, for the comparable 2011 period. The decrease in net loss is attributable to the reasons discussed above.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2012, we had approximately $29,020,000 of total liquid assets, comprised of $25,236,000 of cash and cash equivalents and marketable securities available-for-sale totaling $3,784,000. We believe that our liquidity will be sufficient to meet our cash requirements for at least the next 12 months. As of March 31, 2012, our marketable securities had a weighted average yield to maturity of 1.39% and maturity dates ranging from June 2012 to January 2013. Our net cash generated from continuing operations for the three-month period ended March 31, 2012 was $1,716,000 versus $1,467,000 for the comparable period in 2011. The year-over-year increase in cash generated from continuing operations is primarily attributable to a decrease in our loss from continuing operations and changes to working capital. Our net cash (used in) provided by discontinued operations was ($494,000) for the three-month period ended March 31, 2012 versus $112,000 for the comparable period in 2011. Our net cash (used in) provided by investing activities was ($183,000) in 2012, which was primarily from the purchase of equipment. Our net cash used in financing activities in 2012 was ($227,000), resulting from the settlement of tax withholding obligations from restricted stock vestings, partially offset by proceeds from stock option exercises. As of March 31, 2012 working capital, which is our total current assets minus our total current liabilities, was $31,250,000, as compared to $29,721,000 as of December 31, 2011.

In response to the instability in the financial markets, we regularly review our marketable securities holdings, and have invested primarily in securities of the U.S. government and its agencies.

We may expand or enhance our business in the future by using our resources to acquire by license, purchase or other arrangements, additional businesses, new technologies, or products in the field of dermatology. Accordingly, we may also seek to raise funds through financing transactions. We cannot predict whether financing will be available at all or on reasonable terms.

In January 2012, and based on our merger with Sirius Laboratories, Inc. which closed in March 2006, we paid to the former Sirius shareholders, on a pro rata basis, $250,000. No other payments are due pursuant to the merger agreement. Also in

Table of Contents

January 2012, we made our final royalty payment to Perrigo Pharmaceuticals Company in the amount of $250,000 under our former agreement for supply of a Non-PDT product.

We have no off-balance sheet financing arrangements.

Contractual Obligations and Other Commercial Commitments

PARTEQ Agreement

We license certain patents underlying our Levulan® PDT system under a license agreement with PARTEQ Research and Development Innovations, or PARTEQ. Under the agreement, we have been granted an exclusive worldwide license, with a right to sublicense, under PARTEQ patent rights, to make, have made, use and sell certain products, including ALA. The agreement covers certain use patent rights. When we sell our products directly, we have agreed to pay to PARTEQ royalties of 6% and 4% on 66% of the net selling price in countries where patent rights do and do not exist, respectively. In cases where we have a sublicensee, we will pay 6% and 4% when patent rights do and do not exist, respectively, on our net selling price less the cost of goods for products sold to the sublicensee, and 6% of payments we receive on sales of products by the sublicensee. We are also obligated to pay to PARTEQ 5% of any lump sum sublicense fees received, such as milestone payments, excluding amounts designated by the sublicensee for future research and development efforts.

For the three-month periods ended March 31, 2012 and March 31, 2011, actual royalties based on product sales were approximately $500,000 and $411,000, respectively. For the years ended December 31, 2011, 2010 and 2009, actual royalties based on product sales were approximately $1,653,000, $1,331,000 and $1,019,000, respectively. Annual minimum royalties to PARTEQ must total at least CDN $100,000 (U.S. $100,000 as of March 31, 2012).

National Biological Corporation Amended And Restated Purchase And Supply Agreement

On November 29, 2011, we entered into the 2011 Amended and Restated Purchase and Supply Agreement, or the 2011 NBC Agreement, with National Biological Corporation, or NBC, the primary manufacturer of our BLU-U® light source. The 2011 NBC Agreement includes similar terms and conditions to our Amended and Restated Purchase and Supply Agreeme