MEDIMMUNE INC /DE
Form 10-Q
November 01, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

0-19131

(Commission File No.)

MedImmune, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**52-1555759**
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

One MedImmune Way, Gaithersburg, MD 20878

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code **(301) 398-0000**

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

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

As of October 24, 2006, 239,207,356 shares of Common Stock, par value $0.01 per share, were outstanding.

MEDIMMUNE, INC.

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Unless otherwise indicated, this Quarterly Report is current as of September 30, 2006 and the Company undertakes no obligation to update it to reflect events or circumstances after the date of this Quarterly Report or to reflect the occurrence of unanticipated events.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MEDIMMUNE, INC.

CONSOLIDATED BALANCE SHEETS

(in millions)

	September 30, 2006 (Unaudited) (In millions)	December 31, 2005
ASSETS:		
Cash and cash equivalents	$ 284.2	$ 153.4
Marketable securities	438.6	457.1
Trade receivables, net	115.3	281.0
Inventory, net	102.4	69.4
Deferred tax assets, net	58.7	58.0
Other current assets	30.5	18.4
Total Current Assets	1,029.7	1,037.3
Marketable securities	749.8	861.4
Property and equipment, net	457.0	381.4
Deferred tax assets, net	333.6	128.6
Intangible assets, net	269.1	323.5
Other assets	84.5	47.8
Total Assets	$ 2,923.7	$ 2,780.0
LIABILITIES AND SHAREHOLDERS EQUITY:		
Accounts payable	$ 38.5	$ 37.0
Accrued expenses	157.9	242.1
Product royalties payable	24.6	93.0
Convertible senior notes		500.0
Other current liabilities	261.5	276.4
Total Current Liabilities	482.5	1,148.5
Long-term debt	1,164.8	5.2
Other liabilities	0.6	55.8
Total Liabilities	1,647.9	1,209.5
Commitments and Contingencies		
SHAREHOLDERS EQUITY:		
Preferred stock, $.01 par value; 5.5 million shares authorized; none issued or outstanding		
Common stock, $.01 par value; 420.0 million shares authorized; 255.5 million shares issued at September 30, 2006 and December 31, 2005	2.6	2.6
Paid-in capital	2,697.8	2,688.5
Accumulated deficit	(935.0)	(842.5)
Accumulated other comprehensive loss	(5.0)	(11.0)
	1,760.4	1,837.6
Less: Treasury stock at cost; 16.2 million shares at September 30, 2006 and 8.5 million shares at December 31, 2005	(484.6)	(267.1)
Total Shareholders Equity	1,275.8	1,570.5
Total Liabilities and Shareholders Equity	$ 2,923.7	$ 2,780.0

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

MEDIMMUNE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in millions, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenues:				
Product sales	$ 158.6	$ 146.0	$ 716.4	$ 739.4
Other revenue	18.6	7.6	31.7	12.5
Total revenues	177.2	153.6	748.1	751.9
Costs and expenses:				
Cost of sales	53.5	48.7	190.6	196.5
Research and development	162.0	119.1	343.6	267.7
Selling, general and administrative	88.2	81.1	382.1	299.5
Other operating expenses	2.2	3.8	13.7	9.3
Acquired in-process research and development		4.7		4.7
Total expenses	305.9	257.4	930.0	777.7
Operating loss	(128.7)	(103.8)	(181.9)	(25.8)
Interest income	19.3	15.1	50.2	49.4
Interest expense	(6.3)	(2.3)	(12.0)	(6.2)
Gain (loss) on investment activities	(8.2)	0.4	(8.1)	(0.5)
Earnings (loss) before income taxes	(123.9)	(90.6)	(151.8)	16.9
Income tax provision (benefit)	(68.1)	(26.5)	(79.8)	11.1
Net earnings (loss)	$ (55.8)	$ (64.1)	$ (72.0)	$ 5.8
Basic earnings (loss) per share	$ (0.23)	$ (0.26)	$ (0.29)	$ 0.02
Shares used in calculation of basic earnings (loss) per share	239.3	245.9	244.3	247.1
Diluted earnings (loss) per share	$ (0.23)	$ (0.26)	$ (0.29)	$ 0.02
Shares used in calculation of diluted earnings (loss) per share	239.3	245.9	244.3	249.4

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

MEDIMMUNE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in millions)

	Nine months ended September 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings (loss)	$ (72.0)	$ 5.8
Adjustment to reconcile net earnings to net cash provided by operating activities:		
Share-based compensation expense	24.2	
Charge for acquired in-process research and development		4.7
Deferred taxes	(65.3)	8.6
Depreciation and amortization	79.2	29.1
Amortization of premium on marketable securities	8.2	11.5
Realized losses on investments	8.1	0.5
Losses on write downs of inventory	9.8	7.6
Decrease in sales allowances	(29.6)	(26.8)
Other, net	5.6	3.2
Other changes in assets and liabilities	(91.4)	(68.5)
Net cash used in operating activities	(123.2)	(24.3)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Decrease in marketable securities, net	124.9	98.3
Capital expenditures	(105.7)	(64.3)
Minority interest investments, net	(29.5)	(12.9)
Purchase of promotion rights from Abbott		(70.0)
Net cash used in investing activities	(10.3)	(48.9)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	51.5	19.7
Excess tax benefits from share-based payment arrangements	3.1	
Share repurchases	(289.6)	(105.9)
Repayments on long-term obligations	(0.7)	(4.5)
Redemption of 1% Convertible Senior Notes	(489.6)	
Proceeds from issuance of long-term debt, net of issuance costs	1,129.2	
Purchase of call options on convertible senior notes	(316.5)	
Proceeds from issuance of warrants	177.0	
Net cash provided by (used in) financing activities	264.4	(90.7)
Effect of exchange rate changes on cash	(0.1)	0.1
Net increase (decrease) in cash and cash equivalents	130.8	(163.8)
Cash and cash equivalents at beginning of period	153.4	171.3
Cash and cash equivalents at end of period	$ 284.2	$ 7.5

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

Supplemental schedule of noncash investing activities:

In August 2005, the Company amended its co-promotion agreement with Abbott Laboratories (Abbott) for sales of Synagis in the United States to, among other things, assume full selling and marketing responsibilities for Synagis beginning in July 2006. In connection with this transaction, the Company recorded an intangible asset of $360.4 million which represents the estimated fair value of the exclusive promotion rights, determined as the aggregate value of the incremental payments to be made to Abbott as a result of the amended terms of the agreement in excess of the value of the co-promotion services to be rendered, as determined under the previous agreement. Of the $360.4 million recorded as an intangible asset, $70.0 million represents cash payments made during Q3 2005 and the remaining balance of $290.4 million represents the present value as of the acquisition date of the future incremental payments that the Company deems probable, which were recorded as liabilities in the consolidated balance sheet.

MEDIMMUNE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Organization

MedImmune, Inc., a Delaware corporation (together with its subsidiaries, the Company), is a biotechnology company headquartered in Gaithersburg, Maryland. The Company is committed to advancing science to develop better medicines that help people live healthier, longer and more satisfying lives. The Company currently focuses its efforts on using biotechnology to produce innovative products for prevention and treatment in the therapeutic areas of infectious disease, cancer and inflammatory disease. The Company s scientific expertise is largely in the areas of monoclonal antibodies and vaccines. The Company markets four products: Synagis, FluMist, Ethyol and CytoGam, and has a diverse pipeline of development-stage products.

2. Summary of Significant Accounting Policies

General

The financial information presented as of and for the three and nine months ended September 30, 2006 (Q3 2006 and YTD 2006, respectively) and as of and for the three and nine months ended September 30, 2005 (Q3 2005 and YTD 2005, respectively) is unaudited. In the opinion of the Company s management, the financial information presented herein contains all adjustments necessary for a fair statement of results for the interim periods presented. The Company s operations and financial results are highly seasonal. Interim results are not necessarily indicative of results for an entire year or for any subsequent interim period. These consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2005 and the Company s Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006. The December 31, 2005 consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Seasonality

The Company s largest revenue-generating product, Synagis, is used to prevent respiratory syncytial virus (RSV) disease in high-risk infants. RSV is most prevalent in the winter months in the Northern Hemisphere. Because of the seasonal nature of RSV, limited sales, if any, of Synagis are expected in the second and third quarters of any calendar year, causing financial results to vary significantly from quarter to quarter.

FluMist is a nasally delivered live, attenuated vaccine used to help prevent influenza in healthy individuals from 5 to 49 years of age. As influenza is most prevalent in the fall and winter months in the Northern Hemisphere, the majority of FluMist sales are expected to occur during the second half of any calendar year, causing financial results to vary significantly from quarter to quarter.

Intangible Assets

Management assesses intangible assets for impairment on a periodic basis. The intangible asset associated with the reacquisition of the U.S. co-promotion rights for Synagis is amortized based on total future projected domestic sales of Synagis through the first half of 2009. These projections are evaluated in conjunction with the annual long-range planning process. Should the total of incremental payments, a portion of which are variable based on actual sales, made to Abbott in connection with the reacquisition of the U.S. co-promotion rights for Synagis ultimately be less than the amount of the associated liability recorded, the amount of the intangible asset will be adjusted accordingly.

Product Sales

The Company recognizes revenue on product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is probable. These criteria are generally met upon shipment of product or receipt of product by customers, depending on the contractual terms of the arrangement.

In certain of the Company s international distribution agreements, a portion of the compensation received by the Company from its partner is variable based, in part, on the end-user sales price. When all of the other revenue criteria have been met, the Company recognizes revenue to the extent that the customer has an obligation to pay, the customer has limited or no control over the end-user sales price and, accordingly, any subsequent adjustments to the recorded revenue are not expected to be significant.

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Subsequent adjustments to recorded revenue that result from variances between amounts previously invoiced and the total sales price received are recorded as an adjustment to product sales in the quarter in which they become known.

Sales Allowances

Product sales are recorded net of allowances for estimated chargebacks, returns, discounts, and government rebates. Both in the U.S. and elsewhere, sales of pharmaceutical products depend on the availability of reimbursement to the consumer from third-party payers, such as government and private insurance plans. The Company estimates the portion of its sales that will be covered by government insurance and records allowances at a level that management believes is sufficient to cover estimated requirements for reimbursements.

Contract Revenues

The Company uses the milestone payment method of accounting for contract revenues, recognizing revenue when all milestones to be received under contractual arrangements are determined to be substantive, at-risk and the culmination of an earnings process. Substantive milestones are payments that are conditioned upon an event requiring substantive effort, when the amount of the milestone is reasonable relative to the time, effort and risk involved in achieving the milestone and when the milestones are reasonable relative to each other and the amount of any upfront payment. If all of these criteria are not met, then the Company will use the contingency-adjusted performance model.

Incremental revenue recognized under the amended terms of the Company s international distribution agreement with Abbott International (AI), which represents amounts received in excess of the estimated fair value for product sales of Synagis, are recorded as other revenues in the Company s consolidated statement of operations.

Miscellaneous Revenues

Other revenues may also include licensing fees, grant income, royalty income, corporate funding, and reimbursement of expenses under research and other collaborative agreements. These revenues are recognized when the payments are received or when collection is assured, and only when no further performance obligations exist.

Government Contract

Revenues from the Company s cost plus fixed-fee government contract are recognized as the costs are incurred, and fees are recognized on a pro rata basis of costs incurred to date to total estimated costs. Reimbursement of certain direct and indirect costs is recorded utilizing provisional rates, which are subject to periodic review, audit and adjustment to reflect actual rates.

Other Operating Expenses

Other operating expenses include manufacturing start-up costs and other manufacturing related costs associated with pre-approval products, as well as excess capacity charges associated with the plasma production portion of the Frederick Manufacturing Center.

Stock-based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123R, a revision of SFAS 123, Share-based Payments. SFAS 123R requires public companies to recognize expense associated with share-based compensation arrangements, including employee stock options, using a fair value-based option pricing model, and eliminates the alternative to use the intrinsic value method of accounting for share-based payments under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). SFAS 123R is effective for the Company s fiscal year beginning January 1, 2006. Adoption of the expense provisions of the statement has had and is expected to continue to have a material impact on the Company s results of operations. The Company adopted SFAS 123R using the modified prospective transition method. Under this method, compensation expense has been reflected in the financial statements beginning January 1, 2006 with no restatement of prior periods. As such, compensation expense is recognized for awards that are granted, modified, repurchased or cancelled on or after January 1, 2006 as well as for the portion of awards previously granted that had not vested as of January 1, 2006. The Company has implemented the straight-line expense attribution method, whereas the Company s previous expense attribution method was the graded-vesting method, an accelerated method, described by FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans (FIN 28).

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions to share-based employee compensation in Q3 2005 and YTD 2005 (in millions, except per share data):

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		Q3 2005	YTD 2005
Net earnings (loss), as reported		$ (64.1)	$ 5.8
Add:	share-based employee compensation expense included in historical results for the vesting of stock options assumed in conjunction with the Company s acquisition of Aviron in January 2002, calculated in accordance with FIN 44, Accounting for Certain Transactions Involving Stock Compensation-an Interpretation of APB 25, net of related tax effect		0.1
Deduct:	share-based employee compensation expense determined under the fair value based method for all awards, net of related tax effect	(9.9)	(34.5)
Pro forma net earnings (loss)		$ (74.0)	$ (28.6)
Basic earnings (loss) per share, as reported		$ (0.26)	$ 0.02
Basic earnings (loss) per share, pro forma		$ (0.30)	$ (0.12)
Diluted earnings (loss) per share, as reported		$ (0.26)	$ 0.02
Diluted earnings (loss) per share, pro forma		$ (0.30)	$ (0.12)

New Accounting Standards

In July 2006, the FASB issued FASB Interpretation Number 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company is currently assessing the impact of the interpretation on its financial statements and will adopt the provisions of this interpretation beginning in the first quarter of 2007.

3. Collaborative Agreements

In August 2006, the Company entered into a collaborative agreement with Infinity Pharmaceuticals, Inc. (Infinity) to jointly develop and commercialize novel small molecule cancer drugs targeting Heat Shock Protein 90 (Hsp90) and the Hedgehog cell-signaling pathway. Under the terms of the agreement, the Company will make upfront payments to Infinity totaling $70.0 million, which were recorded as research and development expense in Q3 2006, and agreed to potential development and sales-related milestone payments of up to $430.0 million.

The Company recorded charges totaling $71.7 million and $72.9 million in Q3 2006 and YTD 2006, respectively, and $35.2 million and $40.6 million during Q3 2005 and YTD 2005, respectively, associated with upfront fees and milestone payments under licensing agreements and research collaborations. Such amounts are included as a component of research and development expense in the accompanying statements of operations.

4. Intangible Assets

Intangible assets are comprised of the following (in millions):

	September 30, 2006 Gross Carrying Amount	Accumulated Amortization	December 31, 2005 Gross Carrying Amount	Accumulated Amortization
Promotion rights reacquired from Abbott	$ 360.4	$ (91.3)	$ 360.4	$ (41.3)
Manufacturing know-how acquired from Evans	39.0	(39.0)	39.0	(34.6)
Other intangible assets	0.4	(0.4)	0.4	(0.4)
Total	$ 399.8	$ (130.7)	$ 399.8	$ (76.3)

The Company recorded an intangible asset of $360.4 million during the third quarter of 2005 in conjunction with the reacquisition of the co-promotion rights for Synagis in the United States. Amortization of the intangible asset is computed based on projected future sales of

Synagis over the expected period of active sales and marketing efforts in the United States, which is projected to continue through the first half of 2009.

Amortization for the Company s intangible assets for Q3 2006 and Q3 2005 was $4.6 million and $6.1 million, respectively.Amortization for YTD 2006 and YTD 2005 was $54.4 million and $10.5 million, respectively. The estimated aggregate amortization for the remaining life of the assets is as follows (in millions):

For the three months ended December 31, 2006	$ 41.0
For the year ended December 31, 2007	104.5
For the year ended December 31, 2008	90.7
For the year ended December 31, 2009	32.9
	$ 269.1

5. Inventory

Inventory, net of valuation reserves, is comprised of the following (in millions):

	September 30, 2006	December 31, 2005
Raw Materials	$ 13.6	$ 11.1
Work-in-Process	23.9	42.4
Finished Goods	64.9	15.9
	$ 102.4	$ 69.4

The Company recorded permanent inventory write-downs totaling $0.9 million during Q3 2006 and $9.8 million and $7.6 million during YTD 2006 and YTD 2005, respectively, in cost of sales to reflect total FluMist inventories at net realizable value. No permanent inventory write-downs were recorded during Q3 2005.

6. Credit Facility

On April 25, 2006, the Company entered into a $600.0 million credit facility with a three-year term. The credit facility provides for revolving borrowings and letters of credit collateralized by the Company s marketable securities, which become restricted to the extent the credit facility is utilized. Borrowings bear interest at a variable rate based on prime or LIBOR rates, and the Company is obligated for a commitment fee associated with the unused portion of the credit facility. The credit facility contains covenants restricting the ability of the Company and its subsidiaries to incur indebtedness, grant liens, merge or liquidate, or make certain investments. As of September 30, 2006, there were no outstanding borrowings under the credit facility. As of September 30, 2006, there was $4.4 million of restricted collateral under the credit facility related to outstanding letters of credit, which is included in other long-term assets in the accompanying balance sheet.

7. 1% Convertible Senior Notes Due 2023

On July 10, 2006, most of the holders of the Company s 1% convertible senior notes exercised their put options requiring the Company to redeem the notes for cash at 100% of the principal amount of the notes, plus accrued and unpaid interest. On July 17, 2006, the Company paid $492.1 million to redeem the notes, including $489.6 million in aggregate principal amount and $2.5 million in accrued and unpaid interest. The remaining $10.4 million aggregate principal amount was not redeemed and is classified as long-term debt in the accompanying balance sheet, as holders of the notes are not able to exercise a put option requiring redemption until July 2009.

8. Long-term Debt

During June 2006, the Company issued in a private placement $575 million aggregate principal amount of convertible senior notes due 2011 (2011 Notes) and $575 million aggregate principal amount of convertible senior notes due 2013 (2013 Notes) (collectively referred to as the Notes). The 2011 Notes and 2013 Notes bear interest at 1.375% per annum and 1.625% per annum, respectively, in each case payable semi-annually in arrears on January 15 and July 15 of each year.

The Notes are senior unsecured obligations of the Company, and are convertible into cash and, if applicable, shares of our common stock based on an initial conversion rate, subject to adjustment, of 29.9679 shares per $1,000 principal amount of Notes (which represents an initial conversion price of approximately $33.37 per share). Upon conversion, a holder would receive cash up to the principal amount of the note and the Company s common stock in respect of such note s conversion value in excess of such principal amount. The Notes are convertible only in the following circumstances: (1) if the closing sale price of the Company s common stock exceeds 130% of the conversion price during a period as defined in the indenture; (2) if the average trading price per $1,000 principal amount of the Notes is less than or equal to 97% of the average conversion value of the Notes during a period as defined in the indenture; (3) upon the occurrence of specified corporate

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transactions; and (4) at any time during the 30 day period immediately preceding the maturity date. Upon a change in control or termination of trading, holders of the Notes may require the Company to repurchase all or a portion of their Notes for cash at a repurchase price equal to 100% of the principal amount, plus any accrued and unpaid interest. During September 2006, the Company filed a registration statement to cover resales of the Notes.

In connection with the issuance of the Notes, the Company entered into separate convertible note hedge transactions and separate warrant transactions with respect to the Company s common stock to reduce the potential dilution upon conversion of the Notes (collectively referred to as the Call Spread Transactions) (see Note 15). As a result of the Call Spread Transactions, the Company does not anticipate experiencing an increase in the total shares outstanding from the conversion of the Notes unless the price of its common stock appreciates above $47.67 per share, effectively increasing the conversion premium to the Company to $47.67. The Company purchased call options to cover approximately 34.5 million shares of the Company s common stock (subject to adjustment in certain circumstances), which is the number of shares underlying the Notes. In addition, the Company sold warrants permitting the purchasers to acquire up to approximately 34.5 million shares of the Company s common stock (subject to adjustment in certain circumstances).

Other long-term debt includes the remaining $10.4 million aggregate principal amount of the 1% convertible senior notes as of September 30, 2006 and collateralized loans totaling $4.4 million and $5.2 million as of September 30, 2006 and December 31, 2005, respectively.

9. Government Contract

During the second quarter of 2006, the Company was awarded a five-year contract from the U.S. Department of Health and Human Services to develop cell-based seasonal and pandemic vaccines using our proprietary live, attenuated, intranasal influenza vaccine technology. The contract is cost-reimbursable plus a fixed fee and is initially anticipated to generate revenue of approximately $170.0 million. The Company recognized $3.5 million and $5.8 million of revenues under the contract in Q3 2006 and YTD 2006, respectively, which is included in other revenue in the accompanying statements of operations. As of September 30, 2006, approximately $5.8 million is due from the government, which is included in other current assets in the accompanying balance sheet.

10. Share-based Compensation

As of September 30, 2006, the Company has a number of share-based compensation plans as described below. The pre-tax compensation cost that has been recognized for those plans is as follows (in millions):

	Q3 2006	YTD 2006
Cost of sales	$ 0.3	$ 0.7
Research and development	2.4	7.6
Selling, general and administrative	4.9	15.9
	$ 7.6	$ 24.2
Capitalized in inventory	0.4	1.5
Share-based compensation cost	$ 8.0	$ 25.7

The total income tax benefit recognized in the statements of operations for the deductible portion of share-based compensation was $1.6 million in Q3 2006 and $5.0 million in YTD 2006.

The Company grants stock option incentive awards under certain of the following plans. The 2004 Stock Incentive Plan (the 2004 Plan) is used prospectively as the primary plan for employee awards.

Plan	Description	Shares Authorized for Option Grants (in millions)
1991 Plan	Provides option incentives to employees, consultants and advisors of the Company	33.0
1999 Plan	Provides option incentives to employees, consultants and advisors of the Company	23.3
2003 Non-Employee Directors Plan	Provides option incentives to non-employee directors	1.4
2004 Plan	Provides option, stock appreciation rights, restricted stock, stock units and/or stock incentive awards to employees, non-employee directors, consultants and advisors of the Company	21.0

The following compensation plans, for which there are options outstanding but no future grants are intended to be made, were acquired by the Company in connection with its acquisitions of U.S. Bioscience, Inc. and Aviron (Acquired Plans):

Plan	Description
Non-Executive Plan	Provided option incentives to employees who were not officers or directors of U.S. Bioscience, Inc., consultants and advisors of the company
Non-Employee Directors Plan	Provided option incentives to elected non-employee directors of U.S. Bioscience, Inc.
1996 Equity Incentive Plan	Provided incentive and nonstatutory stock options to employees and consultants of Aviron
1999 Non-Officer Equity Incentive Plan	Provided nonstatutory stock options, stock bonuses, rights to purchase restricted stock, and stock appreciation rights to consultants and employees who were not officers or directors of Aviron

Options under all plans normally vest over a three to five year period and have a maximum term of 10 years. The Company has reserved a total of approximately 17.0 million shares of common stock for issuance under these plans as of September 30, 2006. Related stock option activity is as follows (shares in millions):

	1991, 1999 and 2004 Plans		Non-Employee Directors Plans		Acquired Plans	
	Shares	Price per share (1)	Shares	Price per share (1)	Shares	Price per share (1)
Outstanding, Dec. 31, 2002	24.1	$ 33.45	0.9	$ 29.53	3.6	$ 28.17
Granted	5.4	30.18	0.2	35.87		
Exercised	(2.0)	11.61	(0.1)	2.02	(0.7)	21.30
Canceled	(1.4)	41.33			(0.3)	33.98
Outstanding, Dec .31, 2003	26.1	34.00	1.0	30.52	2.6	29.82
Granted	4.9	23.93	0.2	23.17		
Exercised	(1.0)	9.21	(0.2)	1.31	(0.2)	20.86
Canceled	(2.5)	35.51			(0.3)	32.63
Outstanding, Dec. 31, 2004	27.5	33.12	1.0	33.12	2.1	30.48
Granted	5.0	25.78	0.2	26.71		
Exercised	(1.6)	17.16			(0.4)	21.32
Canceled	(2.4)	33.31			(0.3)	36.78
Outstanding, Dec. 31, 2005	28.5	32.58	1.2	31.88	1.4	32.06
Granted	4.0	35.75	0.2	27.12		
Exercised	(1.9)	22.63	(0.1)	6.11	(0.2)	25.36
Canceled	(2.6)	40.80			(0.1)	40.76
Outstanding, Sept. 30, 2006	28.0	$ 32.91	1.3	$ 32.60	1.1	$ 33.02

(1) Price per share is the weighted average exercise price.

The following disclosure provides a description of the significant assumptions used during the first three quarters of 2006, as well as full years 2005, 2004 and 2003 to estimate the fair value of the Company s employee stock option awards.

YTD 2006 and Full Year 2005 - The fair value of employee stock options granted since January 1, 2005 were estimated using a binomial lattice-based valuation model that uses the weighted-average assumptions shown in the table below. The

Company uses historical data to estimate option exercise and employee termination within the binomial model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. Based on an analysis of economic data that marketplace participants would likely use in determining an exchange price for an option, the Company s weighted average estimate of expected volatility for the first three quarters of 2006 and full year 2005 reflects the implied volatility determined from the market prices of traded call options on the Company s stock. The expected life of an option is derived from the output of the binomial model and represents the period of time that options granted are expected to be outstanding; the range given below results from certain groups of employees exhibiting different exercise patterns. The risk-free interest rate is based on the rate currently available for zero-coupon U.S. government issues with a term equal to the contractual life of the option.

	Q1 2006	Q2 2006	Q3 2006	Full Year 2005
Option pricing model	Binomial	Binomial	Binomial	Binomial
Expected stock price volatility	31 %	31 %	32 %	32 %
Expected dividend yield	0 %	0 %	0 %	0 %
Expected life of option-years	4.3 to 4.8	4.5 to 5.4	4.4 to 4.8	4.3 to 5.4
Risk-free interest rate	4.6 %	4.9 %	5.0 %	4.3 %
Weighted average fair value of options granted	$ 12.46	$ 10.84	$ 9.76	$ 8.94

2004 and 2003 - The fair value of employee stock options granted during 2004 and 2003 was estimated using a Black-Scholes model that used the weighted-average assumptions shown in the table below. The expected life of an option was derived from historical stock option exercise experience. The risk-free interest rate was based on the rate then currently available for zero-coupon U.S. government issues with a term equal to the expected life of the option.

	2004	2003
Option pricing model	Black-Scholes	Black-Scholes
Expected stock price volatility	49 %	51 %
Expected dividend yield	0 %	0 %
Expected life of option-years	5.0	5.0
Risk-free interest rate	3.4 %	3.3 %
Weighted average fair value of options granted	$ 11.20	$ 16.55

Additional information related to the plans as of September 30, 2006 is as follows (shares in millions):

	Options Outstanding			Options Exercisable	
Range of exercise prices	Options Outstanding	Wtd Avg Remaining contractual life (yrs)	Wtd. Avg. Exercise Price	Options Exercisable	Wtd. Avg. Exercise Price
$ 0.01 $10.00	1.4	1.2	$ 6.71	1.4	$ 6.71
$10.01 $20.00	1.6	2.5	$ 18.24	1.6	$ 18.24
$20.01 $30.00	12.8	7.1	$ 25.65	8.0	$ 26.03
$30.01 $40.00	8.1	7.2	$ 36.22	4.1	$ 36.68
$40.01 $50.00	3.1	4.9	$ 42.59	3.1	$ 42.59
$50.01 $60.00	0.4	3.5	$ 56.81	0.4	$ 56.81
$60.01 $70.00	2.7	3.4	$ 60.94	2.7	$ 60.94
$70.01 $80.00	0.3	3.9	$ 72.25	0.3	$ 72.25
	30.4	6.0	$ 32.91	21.6	$ 34.12

The total intrinsic value of options exercised during YTD 2006 and the years ended December 31, 2005, 2004 and 2003 was $24.6 million, $24.5 million, $15.5 million and $49.3 million, respectively. The total intrinsic value of options outstanding and options exercisable at September 30, 2006 was $96.8 million and $76.4 million, respectively. The weighted average remaining contractual life of options exercisable at September 30, 2006 was 4.9 years.

A summary of the status of the Company s nonvested shares as of September 30, 2006 and changes during YTD 2006 is presented below (shares in millions):

	1991, 1999 and 2004 Plans		Non-Employee Directors Plans	
Nonvested Shares	Shares	Wtd. Avg. Grant-Date Fair Value	Shares	Wtd. Avg. Grant-Date Fair Value
Nonvested, December 31, 2005	8.1	$ 10.99	0.5	$ 11.91
Granted	4.0	12.19	0.2	10.35
Vested	(3.1)	12.16	(0.2)	13.15
Forfeited	(0.7)	11.16		
Nonvested, September 30, 2006	8.3	11.12	0.5	10.86

As of September 30, 2006, there was approximately $52.3 million of total unrecognized compensation related to nonvested employee stock option awards. Such cost is expected to be recognized as follows: $6.6 million in the fourth quarter of 2006, $19.9 million in 2007, $13.9 million in 2008, $10.3 million in 2009 and $1.6 million in 2010.

The total fair value of shares vested during YTD 2006 and the year ended December 31, 2005 was $39.9 million and $70.1 million, respectively.

A summary of the stock options vested and expected to vest as of September 30, 2006 is presented below (shares and intrinsic value in millions):

	Shares	Wtd Avg Ex. Price	Wtd Avg remaining contractual life (yrs)	Aggregate Intrinsic Value
1991, 1999 and 2004 Plans	26.3	$ 33.09	5.9	$ 85.4
Non-Employee Directors Plans	1.3	32.60	6.5	4.2
Acquired Plans	1.1	33.02	3.6	3.2

In June 2001, the Company introduced an employee stock purchase plan under which 3.0 million shares of common stock were reserved for issuance. Eligible employees may purchase a limited number of shares of the Company s common stock at 85% of the market value at plan-defined dates. Employees purchased 0.1 million shares, 0.3 million shares, 0.2 million shares and 0.2 million shares, for $3.3 million, $5.6 million, $4.6 million and $4.8 million, during YTD 2006, 2005, 2004 and 2003, respectively, under the plan. Expense recognized in Q3 2006 and YTD 2006, determined using the Black-Scholes model, was $0.6 million and $1.6 million, respectively.

11. Income Taxes

The Company s effective tax rate was 55% for Q3 2006 compared to an effective tax rate of 29% for Q3 2005. The Company s effective tax rate was 53% for YTD 2006 compared to an effective tax rate of 65% for YTD 2005.

12. Earnings per Share

The following is a reconciliation of the numerators and denominators of the diluted EPS computation (in millions):

	Q3 2006	Q3 2005	YTD 2006	YTD 2005
Numerator:				
Net (loss) earnings for basic EPS	$ (55.8)	$ (64.1)	$ (72.0)	$ 5.8
Adjustments for interest expense on convertible senior notes, net of tax (1)				
Earnings (loss) for diluted EPS	$ (55.8)	$ (64.1)	$ (72.0)	$ 5.8
Denominator:				
Weighted average shares for basic EPS	239.3	245.9	244.3	247.1
Effect of dilutive securities:				
Stock options and warrants				2.3
Convertible senior notes (1)				
Weighted average shares for diluted EPS	239.3	245.9	244.3	249.4
Basic earnings (loss) per share	$ (0.23)	$ (0.26)	$ (0.29)	$ 0.02
Diluted earnings (loss) per share	$ (0.23)	$ (0.26)	$ (0.29)	$ 0.02

(1) The Company s $500 million 1% convertible senior notes, which represent 7.3 million potential shares of common stock, are included in the calculation of diluted earnings per share for the period of time they are outstanding using the if-converted method whether or not the contingent requirements have been met for conversion to common stock, unless the effect is anti-dilutive. The $1.15 billion convertible senior notes are included in the calculation of diluted earnings per share whether or not the contingent requirements have been met for conversion using the treasury stock method if the conversion price of $33.37 is less than the average market price of the Company s common stock for the period, because upon conversion, the par value is settled in cash and only the conversion premium is settled in shares of the Company s common stock. The Company s convertible senior notes were anti-dilutive for all periods presented.

The Company incurred a net loss for Q3 2006, Q3 2005 and YTD 2006, and accordingly did not assume exercise or conversion of any of the Company s outstanding stock options or warrants during the periods because to do so would be anti-dilutive. As a result, options and warrants to purchase 64.9 million shares (including warrants to acquire 34.5 million shares issued in June 2006) and 33.4 million shares of common stock were outstanding at September 30, 2006 and 2005, respectively, but were excluded from the calculation of diluted earnings per share.

If option exercise prices are greater than the average market price of the Company s common stock for the period presented, the effect of including such options in the earnings per share calculation is anti-dilutive. Options to purchase 18.5 million shares of common stock at prices ranging from $26.35 to $83.25 per share were outstanding as of September 30, 2005, but were not included in the computation of diluted earnings per share for YTD 2005 because the exercise price of the options exceeded the average market price.

13. Investments in Equity Securities

During Q3 2006, the Company recorded an other-than-temporary impairment loss of $8.1 million for one of its minority interest investments based on the duration and magnitude of the decline in the fair value as well as the financial condition and near-term prospects of the investee company.

14. Comprehensive Income

	Q3 2006	Q3 2005	YTD 2006	YTD 2005
Net earnings (loss)	$ (55.8)	$ (64.1)	$ (72.0)	$ 5.8
Change in foreign currency translations adjustment	(0.2)		0.1	(0.8)
Change in unrealized gain (loss) on investments, net of tax	9.1	0.9	5.9	(8.1)
Comprehensive loss	$ (46.9)	$ (63.2)	$ (66.0)	$ (3.1)

15. Shareholders Equity

In connection with the issuance of the Notes (see Note 8) in June 2006, the Company entered into the Call Spread Transactions. The Call Spread Transactions have the effect of reducing the potential dilution upon conversion of the Notes. As a result of the Call Spread Transactions, the Company does not anticipate experiencing an increase in the number of shares outstanding from the conversion of the Notes unless the price of its common stock appreciates above $47.67 per share, effectively increasing the conversion premium to the Company to $47.67. The Call Spread Transactions do not affect the rights of noteholders under the Notes. The Company purchased call options in private transactions to cover approximately 34.5 million shares of the Company s common stock at a strike price of $33.37 per share (subject to adjustment in certain circumstances) for $316.5 million ($201.0 net of tax benefit). The call options generally allow the Company to receive shares of the Company s common stock from counterparties equal to the number of shares of common stock payable to the holders of the Notes upon conversion. These call options will terminate the earlier of the maturity dates of the related senior convertible notes or the first day all of the related senior convertible notes are no longer outstanding due to conversion or otherwise. As of September 30, 2006, the estimated fair value of the call options was $340.7 million. The Company also sold warrants permitting the purchasers to acquire up to approximately 34.5 million shares of the Company s common stock at an exercise price of $47.67 per share (subject to adjustments in certain circumstances) in private transactions for a total proceeds of approximately $177.0 million. The warrants may be settled over specified periods beginning in July 2011 and July 2013. The warrants provide for net share settlement. In no event shall the Company be required to deliver a number of shares in connection with the transaction in excess of twice the aggregate number of warrants. As of September 30, 2006, the estimated fair value of the warrants was $203.7 million. The Company has analyzed the Call Spread Transactions under Emerging Issues Task Force Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company s Own Stock, and determined that they meet the criteria for classification as equity transactions. As a result, in the second quarter of 2006 the Company recorded the purchase of the call options as a reduction in additional paid-in capital and the proceeds of the warrants as an addition to paid-in capital, and the Company will not recognize subsequent changes in fair value of the agreements.

In May 2006, the Board of Directors authorized a new stock repurchase program for up to $500 million of the Company s common stock in the open market or in privately negotiated transactions. The previous stock repurchase program, which was approved in July 2003 for $500 million, was fully utilized as of June 2006. During Q3 2006, the Company repurchased approximately 0.3 million shares of common stock at a cost of $7.7 million, or an average cost of $25.73 per share. During YTD 2006, the Company repurchased approximately 10.0 million shares of common stock at a cost of $289.6 million, or an average cost of $28.95 per share. The Company is holding repurchased shares as treasury shares and is using them for general corporate purposes, including but not limited to issuance upon exercise of outstanding stock options and acquisition-related transactions.

16. Legal Proceedings

The Company s material legal proceedings are described in Note 18 to the consolidated financial statements included with the Company s Annual Report on Form 10-K for the year ended December 31, 2005 and in the update to that note provided in the Company s Quarterly Report on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006. With respect to the legal proceedings described therein, no material developments have occurred except as follows:

Various Patent Litigation Matters

With respect to the Company s lawsuit against Genentech, Inc., Celltech R&D Limited and City of Hope National Medical Center, in April 2004, the United States District Court for the Central District of California dismissed the claims remaining in that case at the time for lack of subject matter jurisdiction. The Company appealed the dismissal to the United States Court of Appeals for the Federal Circuit, and in October 2005, that court issued a decision, affirming the District Court decision which had dismissed all claims. The Company subsequently filed a Petition for Certiorari with the United States Supreme Court as to the subject matter jurisdiction issue which was granted in February 2006. The Supreme Court heard oral arguments with respect to this matter on October 4, 2006 and a decision is pending.

With respect to the Company s lawsuit against Centocor, Inc., the Trustees of Columbia University in the City of New York and the Board of Trustees of the Leland Stanford Junior University, in June 2004, the United States District Court for the District of Maryland dismissed the claims remaining in that case at the time for lack of subject matter jurisdiction. The Company appealed the dismissal to the United States Court of Appeals for the Federal Circuit, and in June 2005, that court issued a decision, affirming the District Court decision which had dismissed all claims. The Company subsequently filed a Petition for Certiorari with the United States Supreme Court as to the subject matter jurisdiction issue and is awaiting a decision on that petition. The Company believes the Supreme Court will not make a decision on its petition until the Genentech matter described above is resolved.

In January 2006, Genentech filed an action against the Company alleging that the Company s Synagis product infringed two United States patents relating to certain lyophilized products. The suit was filed in the United States District Court for the Eastern District of Texas and seeks unspecified money damages, but the Company was never served with the complaint. The Company has been advised that Genentech has withdrawn the complaint with respect to this matter.

Litigation Regarding Generic Version of Ethyol

With respect to the litigation between Sun Pharmaceutical Industries Limited and the Company related to a generic version of Ethyol (amifostine), Sun filed a motion seeking summary judgment and a hearing was held with respect to this motion on October 24, 2006. A decision by the court is pending.

Average Wholesale Price Cases

The status of the various lawsuits by various states and counties alleging manipulation of average wholesale price by several defendants, including the Company, did not change materially during Q3 2006. As of September 30, 2006, the Company estimates the range of potential pre-tax loss from the Alabama action, the Mississippi action, the New York City action and the New York State County actions (both consolidated and unconsolidated) to range from $0 to $15 million, exclusive of alleged treble damages, best price related claims and other asserted state law causes of action.

17. Subsequent Event

On October 24, 2006, Amgen, Inc. acquired the outstanding equity interests of Avidia, Inc., a privately held biopharmaceutical company. The Company s wholly-owned venture capital subsidiary, MedImmune Ventures, Inc., owned approximately 11% of the outstanding equity interests of Avidia. In connection with the transaction, the Company will record a pre-tax gain of approximately $30 million during the fourth quarter of 2006 and could recognize additional gains up to $6 million in the future upon the achievement of certain contingent milestone events.

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

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements regarding future events and future results that are based on current expectations, estimates, forecasts, and the beliefs, assumptions and judgments of our management. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks and uncertainties that are difficult to predict. Readers are referred to the Forward-Looking Statements section in Part I, Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2005 and the Risk Factors section in Part II, Item IA of this Quarterly Report on Form 10-Q.

INTRODUCTION

MedImmune is committed to advancing science to develop better medicines that help people live healthier, longer and more satisfying lives. We currently focus our efforts on using biotechnology to produce innovative products for prevention and treatment in the therapeutic areas of infectious disease, cancer and inflammatory disease. Our scientific expertise is largely in the areas of monoclonal antibodies and vaccines. We market four products: Synagis, FluMist, Ethyol and CytoGam, and have a diverse pipeline of development-stage products.

OVERVIEW

We recorded a net loss of $0.29 per diluted share in YTD 2006 compared to net earnings per diluted share of $0.02 in YTD 2005. The decline in earnings in YTD 2006 is primarily attributable to increased research and development spending, amortization of the intangible asset resulting from the acquisition of Synagis promotion rights, higher selling, general and administrative expenses associated with the expansion of the pediatric sales force, and share-based compensation expense.

During the first three quarters of 2006, we continued to advance our research and development pipeline as follows:

- We submitted a supplemental Biologics License Application to the U.S. Food and Drug Administration (FDA) in July 2006 for approval to use CAIV-T in preventing influenza in children down to one year of age who do not have a history of wheezing or asthma;

- We replied to the complete response letter received from the FDA to our supplemental biologics license application for the potential approval to switch formulations from frozen FluMist to CAIV-T;

- The FDA approved our reverse genetics technology, which is a more timely, reliable, and safer process for producing seasonal and pandemic influenza vaccines;

- Dosing was completed for a Phase 1 study with a vaccine candidate against an H5N1 influenza virus under a Cooperative Research and Development Agreement (CRADA) with the National Institutes of Health (NIH);

- A CRADA was signed with the NIH for the development of vaccine candidates targeting RSV, parainfluenza virus types 1, 2 and 3, and other respiratory viruses;

- We continued with three ongoing studies for Numax, with the expectation of announcing preliminary results from the pivotal Phase 3 trial directly comparing Numax to Synagis during the fourth quarter of 2006;

- Dosing began in a Phase 1 study for lupus patients with a monoclonal antibody targeting interferon alpha;

- We filed an investigational new drug application with the FDA to begin clinical studies in the U.S. with MT103 for the treatment of patients with B-cell-derived non-Hodgkins lymphoma not eligible for curative therapy.

In connection with the ongoing management of our product development programs, we made the decision to stop our Phase 3 efforts with Abegrin in metastatic melanoma. After reviewing the 24-month survival data from our Phase 2 study, we determined that the significant drop in survival benefit previously seen at 12 months would require a significantly larger study to show a clinically meaningful benefit.

In August 2006, we entered into a collaborative agreement with Infinity Pharmaceuticals, Inc. to jointly develop and commercialize novel small molecule cancer drugs targeting Heat Shock Protein 90 (Hsp90) and the Hedgehog cell-signaling pathway. Under the terms of the agreement, we will make upfront payments to Infinity of $70.0 million, which were recognized as research and development expense in Q3 2006 and agreed to potential development and sales-related milestone payments of up to $430.0 million.

During YTD 2006, we earned and recorded $11.9 million in sales royalties and milestone revenues upon approval of Merck & Co., Inc. s human papillomavirus (HPV) vaccine to prevent cervical cancer by the FDA and European Union and achievement of certain sales-related goals, and related to GlaxoSmithKline s European filing for its cervical cancer vaccine. Sales royalties related to Merck s and GSK s HPV vaccines are based on graduated royalty rate structures up to certain annual sales levels.

During the second quarter of 2006, we were awarded a $170.0 million, five-year contract from the U.S. Department of Health and Human Services to develop cell-based seasonal and pandemic vaccines using our proprietary live, attenuated, intranasal influenza vaccine technology. Work on the contract commenced during the second quarter, resulting in the recognition of approximately $5.8 million of revenues for YTD 2006.

During Q3 2006, we began the expansion of our biologics manufacturing facility in Frederick, Maryland at an estimated construction cost of $250.0 million.

On October 24, 2006, Amgen, Inc. acquired the outstanding equity interests of Avidia, Inc., a privately held biopharmaceutical company. The Company s wholly-owned venture capital subsidiary, MedImmune Ventures, Inc., owned approximately 11% of the outstanding equity interests of Avidia. In connection with the transaction, we will record a pre-tax gain of approximately $30 million during the fourth quarter of 2006 and could recognize additional gains up to $6 million in the future upon the achievement of certain contingent milestone events.

In May 2006, the Board of Directors authorized a new stock repurchase program for up to $500.0 million of our common stock in the open market or in privately negotiated transactions. The original stock repurchase program, which was approved in July 2003 for $500.0 million, was fully utilized as of June 2006.

During June 2006, we issued $1.15 billion in convertible senior notes (the Notes) for total proceeds of $1.13 billion, net of debt issuance costs. In connection with the issuance of the Notes, we entered into separate convertible note hedge transactions and separate warrant transactions with respect to our common stock (collectively referred to as the Call Spread Transactions). The Call Spread Transactions have the effect of reducing the potential dilution upon conversion of the Notes. As a result of the Call Spread Transactions, we do not anticipate experiencing dilution from the issuance of the Notes unless the price of our common stock appreciates above $47.67 per share, effectively increasing the conversion premium to $47.67. We purchased call options to cover approximately 34.5 million shares of our common stock at a strike price of $33.37 per share for $316.5 million, and sold warrants to acquire approximately 34.5 million shares of our common stock at a strike price of $47.67 per share for aggregate proceeds of approximately $177.0 million. Concurrently with the sale of the Notes, we used $148.0 million of the net proceeds to repurchase approximately 5.4 million shares of our common stock in privately negotiated transactions. The Notes were issued in part to redeem our $500.0 million of 1% convertible senior notes that were called by most of the bondholders in July 2006. We intend to use the balance of the proceeds for general corporate purposes, including potential acquisitions, in-licensing and collaboration opportunities, and additional share repurchases, pursuant to the company s remaining authority under our $500.0 million share buyback program authorized in May 2006.

Our cash and marketable securities at September 30, 2006 and December 31, 2005 totaled $1.5 billion, reflecting the net proceeds from the June 2006 convertible debt financing and related transactions, offset by the redemption of the majority of our 1% convertible senior notes in July 2006 and repurchases of approximately 10.0 million of our common stock at a total cost of $289.6 million. Also, the third quarter is typically the seasonal low point for cash balances prior to the beginning of the Synagis and FluMist seasons.

CRITICAL ACCOUNTING ESTIMATES

The preparation of consolidated financial statements requires management to make estimates and judgments with respect to the selection and application of accounting policies that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosures of contingent assets and liabilities. We consider an accounting estimate to be critical if the accounting estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made and if changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we reasonably could have used in the current period, would have a material impact on our financial condition or results of operations. For additional information regarding our critical accounting estimates, please refer to Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2005. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in estimates used in these and other items could have a material impact on our financial statements. The following discussion updates the critical accounting estimates information included in the Form 10-K for the year ended December 31, 2005.

Inventory - We may capitalize inventory costs associated with products prior to regulatory approval and product launch, based on management s judgment of probable future commercial use and net realizable value. We could be required to permanently write down any previously capitalized costs related to pre-approval or pre-launch inventory

upon a change in such judgment, due to a denial or delay of approval by regulatory bodies, a delay in commercialization, or other potential factors. Conversely, our gross margins may be favorably impacted if some or all of the inventory previously written down becomes available and is used for commercial sale. There are no inventory amounts related to pre-approval or pre-launch products as of September 30, 2006.

We capitalize inventory costs associated with marketed products based on management s judgment of probable future commercial use and net realizable value. We could be required to permanently write down previously capitalized costs related to commercial inventory due to quality issues or other potential factors. Conversely, our gross margins may be favorably impacted if some or all of the inventory previously written down was recovered through further processing or receipt of a specification waiver from regulatory agencies, and becomes available and is used for commercial sale.

We are required to state all inventory at lower of cost or market. In assessing the ultimate realization of inventories, we are required to make judgments as to multiple factors affecting our inventories and compare these with current or committed inventory levels. In the highly regulated industry in which we operate, certain raw materials, work-in-process and finished goods inventories have expiration dates that must be factored into our judgments about the recoverability of inventory costs. Additionally, if our estimate of a product s demand and pricing as well as sales volumes and production capacity is such that we may not fully recover the cost of inventory, we must consider that in our judgments as well. In the context of reflecting inventory at the lower of cost or market, we will record permanent inventory write-downs as soon as a need for such a write-down is determined. Such write-downs in inventory are permanent in nature, and will not be reversed in future periods.

The valuation of FluMist inventories requires a significant amount of judgment for multiple reasons. Specifically, the manufacturing process is complex, in part due to the required annual update of the formulation for recommended influenza strains, and there can be no guarantee that we will be able to continue to successfully manufacture the product.

The annual FluMist production cycle begins in October of the year prior to the influenza season in which the product will be available for consumption. For example, the production cycle for the 2006/2007 season began in October 2005. Our raw materials have expiration dates (dates by which they must be used in the production process) that range from 24 months to 60 months. Our semi-processed raw materials and work-in-process inventory have multiple components, each having different expiration dates that range from nine to 24 months. Raw materials, semi-processed raw materials, work-in-process inventory and semi-finished goods may be carried over to succeeding production seasons under certain conditions. Each season s finished FluMist product has an approved shelf life up to six months.

For all FluMist inventory components on hand as of September 30, 2006, we reviewed the following assumptions to determine the amount of any necessary reserves: expected production levels and estimated cost per dose; sales volume projections that are subject to variability; the expected price to be received for the product and anticipated distribution costs; utilization of semi-finished goods inventory for the succeeding production season; and current information about the influenza strains recommended by the Centers for Disease Control and Prevention for each season s vaccine. The methodology used to calculate adjustments required to value our FluMist inventories as of September 30, 2006 at net realizable value was consistent with the methodology used for previous valuations, since product approval in June 2003.

The valuation of inventory as of September 30, 2006 is based on sales volume and price estimates for the 2006/2007 season that are largely based on our actual experience for previous seasons and our expectations for the current season. Sales estimates for the 2006/2007 season incorporated into the inventory valuations performed as of March 31, 2006 were lower than the estimate used for valuation at December 31, 2005, resulting in a permanent write-down of $7.2 million in the first quarter of 2006. Sales estimates for the 2006/2007 season incorporated into the inventory valuations performed as of June 30, 2006 were slightly higher than the estimate used for valuation at March 31, 2006, resulting in a reduction of cost of goods sold of $2.9 million during the second quarter of 2006 to reflect the higher net realizable value. There were no changes in sales estimates for the 2006/2007 season for purposes of the inventory valuation performed as of September 30, 2006.

The table below summarizes the activity within the components of FluMist inventories (in millions):

	Gross Inventory	Reserves	Net Inventory
FluMist Details			
As of December 31, 2005	$ 56.4	$ (37.8)	$ 18.6
Raw materials, net	(4.4)	1.1	(3.3)
Cost of goods sold recognized on 2005/2006 inventory	(1.9)	0.6	(1.3)
Cost of goods sold recognized on 2006/2007 inventory	(16.9)	3.5	(13.4)
Production, net	33.6	(5.8)	27.8
Disposals and scrap	(33.8)	32.9	(0.9)
As of September 30, 2006	$ 33.0	$ (5.5)	$ 27.5

Because finished FluMist product has an approved shelf life up to six months, no finished product for a particular flu season

may be sold in a subsequent season. Therefore, if our actual sales fall below our projections, we will be required to write off any remaining finished goods inventory balance at the end of the flu season.

Sales Allowances **Product sales are recorded net of allowances for estimated chargebacks, returns, discounts, and government rebates. Both in the U.S. and elsewhere, sales of pharmaceutical products depend on the availability of reimbursement to the consumer from third-party payers, such as government and private insurance plans. We estimate the portion of our sales that will be covered by government insurance and record allowances at a level that management believes is sufficient to cover estimated requirements for reimbursements. Significant judgment is required in making certain of these estimates. During Q3 2006, we recorded adjustments to our allowance for Medicaid rebates related to Synagis sales, resulting in lower product revenue of $4.1 million.**

Intangible Assets - Management assesses the intangible asset associated with the reacquisition of the U.S. co-promotion rights for Synagis for impairment on a periodic basis; however, no impairments have occurred as of September 30, 2006. Further, the total future projected domestic sales of Synagis through the first half of 2009, used as the basis for amortization of the related intangible asset, have not been revised based on quarterly sales results through September 30, 2006. Management will assess the estimate of total future domestic Synagis sales in conjunction with the annual long range planning process to be performed in the fourth quarter of 2006. If the total of incremental payments, a portion of which are variable based on actual sales, made to Abbott in connection with the reacquisition of co-promotion rights are ultimately less than the amount of the associated liability recorded, the amount of the intangible asset will be adjusted accordingly.

Investments in Debt and Equity Securities During Q3 2006, we recorded an other-than-temporary impairment loss of $8.1 million for one of our minority interest investments based on the duration and magnitude of the decline in the fair value as well as the financial condition and near-term prospects of the investee company.

NEW ACCOUNTING STANDARDS

Issued in December 2004, Statement of Financial Accounting Standards No.123R (SFAS 123R) requires public companies to recognize expense associated with share-based compensation arrangements, including employee stock options and stock purchase plans, using a fair value-based option pricing model, and eliminates the alternative to use the intrinsic value method of accounting for share-based payments. SFAS 123R is effective for our fiscal year beginning January 1, 2006. Adoption of the expense provisions of SFAS 123R has a material impact on our results of operations. We have applied the modified prospective transition method; accordingly, compensation expense is reflected in the financial statements beginning January 1, 2006 with no restatement of prior periods. Compensation expense is recognized for awards that are granted, modified, repurchased or cancelled on or after January 1, 2006, as well as for the portion of awards previously granted that have not vested as of January 1, 2006. For the adoption of SFAS 123R, we have selected the straight-line expense attribution method, whereas our previous expense attribution method was the graded-vesting method, an accelerated method, described by FIN 28.

Any future changes to our share-based compensation strategy or programs would likely affect the amount of compensation expense recognized under SFAS 123R and the comparability to our prior period footnote disclosures of pro forma net earnings and earnings per share. Share-based compensation expense recognized in Q3 2006 and YTD 2006 totaled $7.6 million and $24.2 million, respectively, on a pre-tax basis, and $6.0 million and $19.2 million, respectively, after tax. Share-based compensation capitalized in inventory was $0.4 million and $1.5 million in Q3 2006 and YTD 2006, respectively.

In July 2006, the FASB issued FASB Interpretation Number 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and

measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We are currently assessing the impact of the interpretation on our financial statements and will adopt the provisions of this interpretation beginning in the first quarter of 2007.

Sales Allowances Product sales are recorded net of allowances for estimated chargebacks, returns, discounts, ar

RESULTS OF OPERATIONS

Q3 2006 compared to Q3 2005

Revenues Product Sales

(in millions)	Q3 2006	Q3 2005	Change	
Synagis				
Domestic	$ 45.3	$ 42.8	6	%
International	66.3	58.2	14	%
	111.6	101.0	11	%
Ethyol				
Domestic	22.3	23.5	(5	)%
International	0.1	1.2	(91	)%
	22.4	24.7	(9	)%
FluMist	15.9	10.4	52	%
Other Products	8.7			

Sales Allowances Product sales are recorded net of allowances for estimated chargebacks, returns, discounts, ar