

BIOSPECIFICS TECHNOLOGIES CORP  
Form 10-Q  
May 10, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended 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 \_\_\_\_\_

001-34236  
(Commission file number)

BIOSPECIFICS TECHNOLOGIES CORP.  
(Exact Name of Registrant as Specified in Its Charter)  
Delaware 11-3054851  
(State or Other Jurisdiction (I.R.S. Employer  
of Incorporation or Organization) Identification No.)  
35 Wilbur Street Lynbrook, NY 11563  
(Address of Principal Executive Offices) (Zip Code)

516.593.7000  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant 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.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

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Yes ☐ No ☒

Indicate the number of shares outstanding of the issuer's classes of common stock, as of the latest practicable date:

Class of Stock	Outstanding April 27, 2012
Common Stock (\$.001 par value)	6,347,297

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BIOSPECIFICS TECHNOLOGIES CORP.

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Introductory Comments – Terminology

Throughout this quarterly report on Form 10-Q (this “Report”), the terms “BioSpecifics,” “Company,” “we,” “our,” and “us” to BioSpecifics Technologies Corp. and its subsidiary, Advance Biofactures Corp. (“ABC-NY”).

Introductory Comments – Forward-Looking Statements

This Report includes “forward-looking statements” within the meaning of, and made pursuant to the safe harbor provisions of, the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management, expected revenue growth, and the assumptions underlying or relating to such statements, are “forward-looking statements”. In some cases, you can identify these statements by forward-looking words such as “believe,” “expect,” “anticipate,” “plan,” “estimate,” “likely,” “may,” “will,” “continue,” “project,” “predict,” “goal,” the negative or plural of these words, and other similar expressions. Our forward-looking statements are predictions based on our current expectations and our projections about future events. There are a number of important factors that could cause our actual results to differ materially from those indicated by such forward-looking statements, including the statements made by us or by our partner Auxilium Pharmaceuticals, Inc. regarding progress toward achievement of its objectives for the sale and marketing of XIAFLEX® for Dupuytren’s contracture in the U.S., including, among other things, developments in the reimbursement process; the ability of Pfizer, Inc. to achieve its objectives for XIAPEX® in Europe; the ability of Asahi Kasei Pharma Corporation to achieve its objectives for XIAFLEX in Japan; the ability of Actelion Pharmaceuticals Ltd. to achieve its objectives for XIAFLEX in Canada, Australia, Brazil and Mexico; the success of the Phase III trials for XIAFLEX for the treatment of Peyronie’s disease; the potential market for XIAFLEX in a given indication; the initiation and outcome of clinical trials for additional indications including frozen shoulder, cellulite, human lipoma and canine lipoma, all of which will determine the amount of milestone, royalty and sublicense income we may receive; the potential of XIAFLEX to be used in additional indications; the timing of results of any clinical trials; the timing of regulatory filings and action; the receipt of any applicable milestone payments from Auxilium Pharmaceuticals, Inc.; whether royalty payments we are entitled to receive will exceed set-offs; and other risk factors identified in this Report, our Annual Report on Form 10-K for the year ended December 31, 2011 and our Current Reports on Form 8-K filed with the Securities and Exchange Commission. All forward-looking statements included in this Report are made as of the date hereof, and we assume no obligation to update these forward-looking statements.

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## PART I – FINANCIAL INFORMATION

## Item 1: Consolidated Financial Statements

BioSpecifics Technologies Corp.  
Consolidated Balance Sheets

	March 31, 2012 (unaudited)	December 31, 2011 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$5,778,036	\$ 3,196,831
Short-term investments	5,000,000	5,000,000
Accounts receivable, net	1,847,372	3,236,917
Income tax receivable	244,720	244,720
Deferred tax assets	1,049,388	1,309,801
Prepaid expenses and other current assets	167,330	98,234
Total current assets	14,086,846	13,086,503
Deferred royalty buy-down	2,750,000	1,250,000
Deferred tax assets - long term	1,738,154	1,738,154
Patent costs, net	177,471	190,416
Total assets	18,752,471	16,265,073
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	2,281,176	601,002
Accrued tax liability	153,060	-
Deferred revenue	345,107	437,099
Accrued liabilities of discontinued operations	78,138	78,138
Total current liabilities	2,857,481	1,116,239
Long-term deferred revenue	259,238	276,520
Stockholders' equity:		
Series A Preferred stock, \$.50 par value, 700,000 shares authorized; none outstanding	-	-
Common stock, \$.001 par value; 10,000,000 shares authorized ; 6,554,743 and 6,530,743 shares issued at March 31, 2012 and December 31, 2011, respectively	6,555	6,531
Additional paid-in capital	20,269,082	20,049,196
Accumulated deficit	(2,549,515 )	(3,291,904 )
Treasury stock, 206,851 and 194,604 shares at cost at March 31, 2012 and December 31, 2011, respectively	(2,090,370 )	(1,891,509 )
Total stockholders' equity	15,635,752	14,872,314
Total liabilities and stockholders' equity	\$18,752,471	\$ 16,265,073

See accompanying notes to consolidated financial statements



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BioSpecifics Technologies Corp.  
Consolidated Statements of Operations  
(unaudited)

	Three Months Ended March 31,	
	2012	2011
Revenues:		
Net sales	\$7,504	\$5,892
Royalties	1,899,969	945,081
Licensing revenues	679,275	859,275
Consulting fees	-	46,667
Total Revenues	2,586,748	1,856,915
Costs and expenses:		
Research and development	249,552	212,066
General and administrative	1,088,722	1,509,526
Total Cost and Expenses	1,338,274	1,721,592
Operating income	1,248,474	135,323
Other income:		
Interest income	9,493	16,560
Income before expense for income tax	1,257,967	151,883
Income tax benefit (expense)	(515,577 )	3,539,240
Net income	\$742,390	\$3,691,123
Basic net income per share	\$0.12	\$0.59
Diluted net income per share	\$0.11	\$0.51
Shares used in computation of basic net income per share	6,336,503	6,293,868
Shares used in computation of diluted net income per share	6,969,936	7,203,324

See accompanying notes to consolidated financial statements

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BioSpecifics Technologies Corp  
Consolidated Statements of Cash Flows  
(unaudited)

	Three Months Ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	\$742,390	\$3,691,123
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	12,945	10,610
Stock-based compensation expense	39,806	133,698
Deferred tax assets	260,413	(3,539,240)
Changes in operating assets and liabilities:		
Accounts receivable	1,389,545	970,098
Prepaid expenses and other current assets	(69,095 )	11,436
Accounts payable and accrued expenses	1,833,233	(447,275 )
Deferred revenue	(109,275 )	(155,943 )
Net cash provided by operating activities	4,099,962	674,507
Cash flows from investing activities:		
Maturity of marketable investments	2,000,000	-
Purchases of marketable investments	(2,000,000)	-
Payment for royalty buy down	(1,500,000)	-
Net cash used in investing activities	(1,500,000)	-
Cash flows from financing activities:		
Proceeds from stock option exercises	78,000	-
Payments for repurchase of common stock	(198,861 )	-
Excess tax benefits from share-based payment arrangements	102,104	-
Net cash used in financing activities	(18,757 )	-
Increase in cash and cash equivalents	2,581,205	674,507
Cash and cash equivalents at beginning of year	3,196,831	2,470,852
Cash and cash equivalents at end of period	\$5,778,036	\$3,145,359
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	-	-
Taxes	-	-

## Supplemental disclosures of non-cash transactions:

Under our agreement with Auxilium certain patent costs paid by Auxilium on behalf of the Company are creditable against future royalties. For the period ended March 31, 2012, we accrued \$15,000 related to certain patent costs of which we amortized \$12,945. For the first quarter of 2011, we accrued \$13,844 related to these costs of which \$10,610 was amortized in 2011.

See accompanying notes to consolidated financial statements





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BIOSPECIFICS TECHNOLOGIES CORP.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2012  
(Unaudited)

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

We are a biopharmaceutical company involved in the development of an injectable collagenase for multiple indications. We are a party to a development and license agreement with Auxilium Pharmaceuticals, Inc. (“Auxilium”) for injectable collagenase (which Auxilium has named XIAFLEX® (collagenase clostridium histolyticum)) for clinical indications in Dupuytren’s contracture, Peyronie’s disease and frozen shoulder (adhesive capsulitis). Auxilium has an option to acquire additional indications that we may pursue, including cellulite, for which we have granted Auxilium the right to initiate early development studies at its cost, and human and canine lipoma. Auxilium is currently selling XIAFLEX in the U.S. for the treatment of Dupuytren’s contracture. Auxilium has an agreement with Pfizer, Inc. (“Pfizer”) pursuant to which Pfizer has the right to market XIAFLEX for Dupuytren’s contracture and Peyronie’s disease in Europe and certain Eurasian countries, and will do so under the registered trademark XIAPEX® (collagenase clostridium histolyticum). Pfizer is currently selling XIAPEX in nine countries in Europe, including the United Kingdom, Germany and Spain. In addition, Auxilium has an agreement with Asahi Kasei Pharma Corporation (“Asahi”) pursuant to which Asahi has the right to commercialize XIAFLEX for the treatment of Dupuytren’s contracture and Peyronie’s disease in Japan. Auxilium also has an agreement with Actelion Pharmaceuticals Ltd. (“Actelion”) pursuant to which Actelion has the right to commercialize XIAFLEX for the treatment of Dupuytren’s contracture and Peyronie’s disease in Canada, Australia, Brazil and Mexico.

Pursuant to a March 2006 agreement (the “DFB Agreement”) between the Company and DFB Biotech, Inc. (“DFB”), we continue to receive earn-out payments based on the sales of Santyl. Our right to receive earn-out payments with respect to the marketed topical product sold to DFB expires in June 2013, but earn-out payments for second generation collagenase products, if any, continue indefinitely.

Operational Highlights

In a February 23, 2012 press release, Auxilium announced that it had entered into a Collaboration Agreement with Actelion pursuant to which Actelion has the right to develop and commercialize XIAFLEX for the treatment of Dupuytren’s contracture and Peyronie’s disease in Canada, Australia, Brazil and Mexico. According to the release, XIAFLEX for the treatment of Dupuytren’s contracture has been accepted for review by Health Canada and regulatory action is expected in the second half of 2012. Additionally, Actelion expects to file for approval of XIAFLEX for the treatment of Dupuytren’s contracture in Australia, Brazil and Mexico over the next 12 months. Under the terms of the agreement with Actelion, Auxilium is to receive a \$10 million upfront payment from Actelion, as well as up to \$16 million in potential regulatory, pricing, and reimbursement milestone payments and \$42.5 million in potential sales milestone payments. Under the terms of our development and license agreement with Auxilium, we will receive a certain percentage from Auxilium in connection with the upfront payment by Actelion, and a specified percentage of any additional milestones received by Auxilium. We will also receive from Auxilium royalties from net sales and payments on costs of goods sold in Canada, Australia, Brazil and Mexico, which will be a specified percentage of what Auxilium is entitled to receive from Actelion without regard to any offset that Actelion may have with respect to Auxilium.

On March 31, 2012, we entered into an amendment to our existing agreement, dated August 27, 2008, related to our future royalty obligations for Peyronie’s disease. The amendment enables us to buy down a portion of our future royalty obligations in exchange for an initial cash payment of \$1.5 million and five additional cash payments payable upon the occurrence of a milestone event.

On May 7, 2012, we announced the initiation of a placebo controlled randomized Phase II clinical trial, Chien-804, to evaluate the efficacy of XIAFLEX for canines with benign subcutaneous lipomas. The single injection study will evaluate 32 dogs randomized 1:1 XIAFLEX to placebo. Auxilium has the option to license development and marketing rights to this canine lipoma indication.

In a May 9, 2012 press release, Auxilium announced that The Journal of Urology had published on its website, Auxilium's phase IIb clinical trial of XIAFLEX for the potential nonsurgical treatment of Peyronie's disease. Top line data from this trial had been previously reported by Auxilium. The study will be included in the June 2012 print version of The Journal of Urology.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements are unaudited, but include all adjustments (consisting only of normal, recurring adjustments) which we consider necessary for a fair presentation of our financial position at such dates and the operating results and cash flows for those periods. Although we believe that the disclosures in our financial statements are adequate to make the information presented not misleading, certain information normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") has been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for quarterly reporting.

The information included in this Report should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC on March 13, 2012.

Principles of Consolidation

The audited consolidated financial statements include the accounts of the Company and its subsidiary, ABC-NY.

Critical Accounting Policies, Estimates and Assumptions

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are based on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results could differ from those estimates.

Cash, Cash Equivalents and Short-term Investments

Cash, cash equivalents and short-term investments are stated at market value. Cash equivalents include only securities having a maturity of three months or less at the time of purchase. The Company limits its credit risk associated with cash, cash equivalents and short-term investments by placing its investments with banks it believes are highly creditworthy and with highly rated money market funds, U.S. government securities, or certificates of deposit.

Fair Value Measurements

The Fair Value Measurements and Disclosures Topic of the Accounting Standards Codification defines fair value, establishes a framework for measuring fair value in applying generally accepted accounting principles, and expands disclosures about fair value measurements. This Codification topic identifies two kinds of inputs that are used to determine the fair value of assets and liabilities: observable and unobservable. Observable inputs are based on market data or independent sources while unobservable inputs are based on our own market assumptions. Once inputs have been characterized, this Codification topic requires us to prioritize the inputs used to measure fair value into one of three broad levels. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values identified by Level 2 inputs utilize observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities. Fair values identified by Level 3 inputs are unobservable data points and are used to measure fair value to the extent that observable inputs are not available. Unobservable inputs reflect our own assumptions about the assumptions that market participants would use in pricing the asset or liability.



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The following table presents information about our assets and liabilities that are measured at fair value on a recurring basis for the period presented and indicates the fair value hierarchy of the valuation techniques we utilized to determine such fair value.

March 31, 2012	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Cash and cash equivalents	\$5,778,036	\$ 5,778,036	-	-
Certificates of Deposit	5,000,000	5,000,000	-	-

## Revenue Recognition

We currently recognize revenues resulting from product sales, the licensing and sublicensing of the use of our technology and from services we sometimes perform in connection with the licensed technology under the guidance of Accounting Standards Codification 605, Revenue Recognition (“ASC 605”).

If we determine that separate elements exist in a revenue arrangement under ASC 605, we recognize revenue for delivered elements only when the fair values of undelivered elements are known, when the associated earnings process is complete, when payment is reasonably assured and, to the extent the milestone amount relates to our performance obligation, when our customer confirms that we have met the requirements under the terms of the agreement.

Revenues, and their respective treatment for financial reporting purposes, are as follows:

## Product Sales

We recognize revenue from product sales of lab reagents when there is persuasive evidence that an arrangement exists, title passes, the price is fixed or determinable and collectability is reasonably assured. No right of return exists for our products except in the case of damaged goods. To date, we have not experienced any significant returns of our products.

Net sales include the sales of the collagenase for laboratory use that are recognized at the time the product is shipped to customers for laboratory use.

## Royalty / Mark-up on Cost of Goods Sold / Earn-Out Revenue

For those arrangements for which royalty, mark-up on cost of goods sold or earn-out payment information becomes available and collectability is reasonably assured, we recognize revenue during the applicable period earned. For interim quarterly reporting purposes, when collectability is reasonably assured but a reasonable estimate of royalty, mark-up on cost of goods sold or earn-out payment revenues cannot be made, the royalty, mark-up on cost of goods sold and earn-out payment revenues are generally recognized in the quarter that the applicable licensee provides the written report and sufficient related information to us.

Under our development and license agreement with Auxilium (as amended and restated on each of December 11, 2008 and August 31, 2011, the “Auxilium Agreement”), we do not participate in the selling, marketing or manufacturing

of products for which we receive royalties and a mark-up of the cost of goods sold revenues. The royalty and mark-up on cost of goods sold revenues will generally be recognized in the quarter that Auxilium provides the written reports and related information to us, that is, royalty and mark up on cost of goods sold revenues are generally recognized one quarter following the quarter in which sales by Auxilium occurred. The royalties payable by Auxilium to us are subject to set-off for certain patent costs.

Under a March 2006 agreement (the “DFB Agreement”), pursuant to which we sold our topical collagenase business to DFB Biotech, Inc. and its affiliates (“DFB”), we have the right to receive earn-out payments in the future based on sales of certain products. Generally, under the DFB Agreement we would receive payments and a report within ninety (90) days from the end of each calendar year after DFB has sold the royalty-bearing product. Currently, DFB is providing us earn-out reports on a quarterly basis.

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### License Revenue

We include revenue recognized from upfront licensing, sublicensing and milestone payments in “License Revenues” in our consolidated statements of operations in this Report.

### Upfront License and Sublicensing Fees

We generally recognize revenue from upfront licensing and sublicensing fees when the agreement is signed, we have completed the earnings process and we have no ongoing performance obligation with respect to the arrangement. Nonrefundable upfront technology license for product candidates for which we are providing continuing services related to product development are deferred and recognized as revenue over the development period.

### Milestones

Milestones, in the form of additional license fees, typically represent nonrefundable payments to be received in conjunction with the achievement of a specific event identified in the contract, such as completion of specified development activities and/or regulatory submissions and/or approvals. We believe that a milestone represents the culmination of a distinct earnings process when it is not associated with ongoing research, development or other performance on our part. We recognize such milestones as revenue when they become due and collection is reasonably assured. When a milestone does not represent the culmination of a distinct earnings process, we recognize revenue in a manner similar to that of an upfront license fee.

The timing and amount of revenue that we recognize from licenses of technology, either from upfront fees or milestones where we are providing continuing services related to product development, is primarily dependent upon our estimates of the development period. We define the development period as the point from which research activities commence up to regulatory approval of either our or our partners’ submission assuming no further research is necessary. As product candidates move through the development process, it is necessary to revise these estimates to consider changes to the product development cycle, such as changes in the clinical development plan, regulatory requirements, or various other factors, many of which may be outside of our control. Should the U.S. Food and Drug Administration or other regulatory agencies require additional data or information, we would adjust our development period estimates accordingly. The impact on revenue of changes in our estimates and the timing thereof is recognized prospectively over the remaining estimated product development period.

### Consulting and Technical Assistance Services

We recognize revenues from consulting and technical assistance contracts primarily as a result of the DFB Agreement. Consulting revenues are recognized ratably over the term of the contract. The consulting and technical assistance obligations to DFB expired in March 2011.

### Treasury Stock

The Company accounts for treasury stock under the cost method and includes treasury stock as a component of stockholders’ equity.

### Accounts receivable and Allowance for Doubtful Accounts

Trade accounts receivable are stated at the amount the Company expects to collect. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. We consider the following factors when determining the collectability of specific customer accounts: customer



credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Our accounts receivable balance is typically due from its two large pharmaceutical customers. These companies have historically paid timely and have been financially stable organizations. Due to the nature of the accounts receivable balance, we believe the risk of doubtful accounts is minimal. If the financial condition of our customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. We provide for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after we have used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. We recorded no material bad debt expense in the quarter ended March 31, 2012. The allowance for doubtful accounts balance as of March 31, 2012 and 2011 was \$30,095.

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Accounts receivable as of March 31, 2012 is approximately \$1.8 million, which consists of approximately \$0.3 million due from DFB in accordance with the earn-out under the DFB Agreement and approximately \$1.5 million in royalties due from Auxilium in accordance with the terms of the Auxilium Agreement.

### Reimbursable Third Party Development Costs

We accrue patent expenses that are reimbursable by us under the Auxilium Agreement. We capitalize certain patent costs related to estimated third party development costs that are reimbursable under the Auxilium Agreement. In August 2011, through the amendment and restatement of our development and license agreement with Auxilium, we have clarified the rights and responsibilities of the joint development of XIAFLEX. We resolved what had been an on-going dispute with Auxilium concerning the appropriate amount of creditable third party development expenses related to the lyophilization of the injection formulation and certain patent expenses for research and development costs that were reimbursable under the Auxilium Agreement. We do not expect any additional third party development cost related to the lyophilization of the injection formulation. Any estimates of patent costs are based on contractual terms, historical costs, reviewing third party data and expectations regarding future development for certain products.

If conditions or other circumstances change, we may take actions to revise our reimbursable third party patent cost estimates. These revisions could result in an incremental increase or decrease in research and development costs. For example, the Auxilium Agreement provides that Auxilium and BioSpecifics will share equally certain patent expenses which are creditable against future royalty revenues.

As of March 31, 2012 our net reimbursable third party patent costs accrual was approximately \$15,000.

### Research and Development Expenses

Research and development ("R&D") expenses include, but are not limited to, internal costs, such as salaries and benefits, costs of materials, lab expense, facility costs and overhead. R&D expenses also consist of third party costs, such as medical professional fees, product costs used in clinical trials, consulting fees and costs associated with clinical study arrangements. We may fund R&D at medical research institutions under agreements that are generally cancelable. All of these costs are charged to R&D as incurred, which may be measured by percentage of completion, contract milestones, patient enrollment, or the passage of time.

### Clinical Trial Expenses

Our cost accruals for clinical trials are based on estimates of the services received and efforts expended pursuant to contracts with various clinical trial centers and clinical research organizations. In the normal course of business we contract with third parties to perform various clinical trial activities in the ongoing development of potential drugs. The financial terms of these agreements are subject to negotiation and vary from contract to contract and may result in uneven payment flows. Payments under the contracts depend on factors such as the achievement of certain events, the successful enrollment of patients, the completion of portions of the clinical trial, or similar conditions. The objective of our accrual policy is to match the recording of expenses in our financial statements to the actual cost of services received and efforts expended. As such, expenses related to each patient enrolled in a clinical trial are recognized ratably beginning upon entry into the trial and over the course of the patient's continued participation in the trial. In the event of early termination of a clinical trial, we accrue an amount based on our estimate of the remaining non-cancelable obligations associated with the winding down of the clinical trial. Our estimates and assumptions could differ significantly from the amounts that may actually be incurred.

### Stock-Based Compensation

The Company has two stock-based compensation plans in effect. Accounting Standards Codification 718, Compensation - Stock Compensation (“ASC 718”) requires the recognition of compensation expense, using a fair-value based method, for costs related to all share-based awards including stock options and common stock issued to our employees and directors under our stock plans. It requires companies to estimate the fair value of share-based awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense on a straight-line basis over the requisite service periods in our consolidated statements of operations.

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Under the ASC 718, we estimate the fair value of our employee stock awards at the date of grant using the Black-Scholes option-pricing model, which requires the use of certain subjective assumptions. The most significant of these assumptions are our estimates of the expected volatility of the market price of our stock and the expected term of an award. When establishing an estimate of the expected term of an award, we consider the vesting period for the award, our recent historical experience of employee stock option exercises (including forfeitures) and the expected volatility. When there is uncertainty in the factors used to determine the expected term of an award, we use the simplified method. As required under the accounting rules, we review our valuation assumptions at each grant date and, as a result, our valuation assumptions used to value employee stock-based awards granted in future periods may change. The Company did not grant stock options during the three month period ended March 31, 2012.

Further, ASC 718 requires that employee stock-based compensation costs to be recognized over the requisite service period, or the vesting period, in a manner similar to all other forms of compensation paid to employees. The allocation of employee stock-based compensation costs to each operating expense line are estimated based on specific employee headcount information at each grant date and estimated stock option forfeiture rates and revised, if necessary, in future periods if actual employee headcount information or forfeitures differ materially from those estimates. As a result, the amount of employee stock-based compensation costs we recognize in each operating expense category in future periods may differ significantly from what we have recorded in the current period.

Stock-based compensation expense recognized under ASC 718 was as follows:

	Three Months Ended March 31,	
	2012	2011
Research and development	\$ 22,138	\$ 27,116
General and administrative	17,668	106,582
Total stock-based compensation expense	\$ 39,806	\$ 133,698

## Stock Option Activity

A summary of our stock option activity during the three months ended March 31, 2012 is presented below:

Options	Total Number of Shares	Weighted-Average Exercise Price
Outstanding as of December 31, 2011	1,261,425	\$ 8.27
Granted	-	-
Forfeited	-	-
Exercised	24,000	3.25
Expired	-	\$ -
Outstanding as of March 31, 2012	1,237,425	\$ 8.37
Exercisable as of March 31, 2012	1,147,425	\$ 7.28

During the three months ended March 31, 2012 and 2011, \$78,000 and zero, respectively, were received from stock options exercised by option holders.

The aggregate intrinsic value of options outstanding and exercisable as of March 31, 2012 was approximately \$9.8 million. Aggregate intrinsic value represents the total pre-tax intrinsic value, based on the closing price of our common stock of \$15.82 on March 30, 2012, which would have been received by the option holders had all option holders exercised their options as of that date. Total unrecognized compensation cost related to non-vested stock

options outstanding as of March 31, 2012 was approximately \$0.1 million which we expect to recognize over a weighted-average period of 1.0 year.

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### Property, Plant and Equipment

Property, plant and equipment are stated at cost, less accumulated depreciation. Machinery and equipment, furniture and fixtures, and autos are depreciated on the straight-line basis over their estimated useful lives of 5 to 10 years. Leasehold improvements are amortized over the lesser of their estimated useful lives or the remaining life of the lease.

### Income Taxes

Deferred tax assets and liabilities are recognized based on the expected future tax consequences, using current tax rates, of temporary differences between the financial statement carrying amounts and the income tax basis of assets and liabilities. A valuation allowance is applied against any net deferred tax asset if, based on the weighted available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

We use the asset and liability method of accounting for income taxes, as set forth in Accounting Standards Codification 740-10-25-2. Under this method, deferred income taxes, when required, are provided on the basis of the difference between the financial reporting and income tax basis of assets and liabilities at the statutory rates enacted for future periods. In accordance with Accounting Standards Codification 740-10-45-25, Income Statement Classification of Interest and Penalties, we classify interest associated with income taxes under interest expense and tax penalties under other.

### Future Impact of Recently Issued Accounting Standards

In May 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standard ("IFRS"), to converge fair value measurement and disclosure guidance in U.S. GAAP with the guidance in the International Accounting Standards Board's concurrently issued IFRS 13, Fair Value Measurement. The amendments in ASU 2011-04 do not modify the requirements for when fair value measurements apply; rather, they generally represent clarifications on how to measure and disclose fair value under ASC 820, Fair Value Measurement. The amendments in the ASU 2011-04 are effective prospectively for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted for public entities. Adoption of this standard did not have a material impact on the financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income ("ASU 2011-05"). Under ASU 2011-05, an entity will have the option to present comprehensive income on the income statement or as a separate financial statement. ASU 2011-05 is effective January 1, 2012 and requires retrospective adoption. ASU 2011-05 affects financial statement presentation only and has no effect on results of operations or financial position. We were required to adopt the new guidance retrospectively beginning January 1, 2011. Adoption has not had a material effect on our financial statements.

### 3. NET INCOME (LOSS) PER SHARE

In accordance with Accounting Standards Codification 260, Earnings Per Share, basic net income (loss) per share amount is computed using the weighted-average number of shares of common stock outstanding during the periods presented, while diluted net income (loss) per share is computed using the sum of the weighted-average number of common and common equivalent shares outstanding. Common equivalent shares used in the computation of diluted earnings per share result from the assumed exercise of stock options using the converted method.

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The following table summarizes the number of common equivalent shares that were included for the calculation of diluted net income purposes from continuing operations reported in the consolidated statement of operations.

	Three Months Ended March 31,	
	2012	2011
Stock options	633,433	909,456

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## 4. COMPREHENSIVE INCOME (LOSS)

For the quarters ended March 31, 2012 and 2011, we had no components of other comprehensive income or loss other than net income itself.

## 5. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following:

	March 31, 2012	December 31, 2011
Trade accounts payable and accrued expenses	\$ 2,110,170	\$ 407,954
Accrued legal and other professional fees	176,811	50,000
Accrued payroll and related costs	147,257	143,048
Total	\$2,434,238	\$601,002

## 6. PATENT COSTS

We amortize intangible assets with definite lives on a straight-line basis over their estimated useful lives, ranging from 1 to 8 years, and review for impairment on a quarterly basis and when events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

As of March 31, 2012, the Company capitalized certain patent costs, paid by Auxilium on behalf of the Company. These costs are reimbursable to Auxilium under the Auxilium Agreement and are creditable against future royalty revenues. Our net patent costs consisted of:

	March 31, 2012	December 31, 2011
Patents	\$ 318,280	\$ 318,280
Accumulated Amortization	(140,808)	(127,863)
	\$ 177,472	\$ 190,427

The amortization expense for patents was \$12,945 for the three months ended March 31, 2012. In the comparable period of 2011, the amortization expense for patents was \$10,610. The estimated aggregate amortization expense for each of the next five years is approximately as follows:

2013	46,000
2014	36,000
2015	13,000
2016	9,000
2017 through 2020	9,000

## 7. INCOME TAXES

The significant components of the Company's deferred tax assets, pursuant to Accounting Standards Codification 740-10-50 consist of net operating losses, orphan tax credits, stock-based compensation and deferred revenues. For the three month period ended March 31, 2012 net income tax expense was \$0.5 million, primarily a non-cash charge. For the three month period ended March 31, 2012, the valuation allowance with respect to the company's net deferred tax assets remained unchanged. As of March 31, 2012, our remaining deferred tax assets decreased by \$0.3



million to approximately \$2.8 million.

For the three month period ended March 31, 2011, the valuation allowance reversed by approximately \$3.6 million with respect to our net deferred tax assets and corresponding tax benefit reduced our statutory federal tax rate of 34% and resulted in net benefit of \$3.5 million. We determined that it was more likely than not that these deferred tax assets would be realized based on our projected annual profitability of operations driven by our revenues under the Auxilium Agreement. The remaining balance of deferred tax assets as of March 31, 2011 was approximately \$3.5 million.

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8. RELATED PARTY TRANSACTIONS

Our subsidiary, ABC-NY (together with the Company, the “Tenant”) and Wilbur St. Corp. (the “Landlord”) were parties to a lease agreement initially dated as of January 30, 1998 and modified as of June 24, 2009 (the “Lease Agreement”), pursuant to which the Landlord leased to the Tenant the premises located at 35 Wilbur Street, Lynbrook, NY 11563 (the “Premises”) until June 30, 2010 and for a monthly rental price of \$11,250 plus utilities and real estate taxes. Following the expiration of the Lease Agreement, the Tenant has continued to lease the Premises from the Landlord on a month-to-month basis. We notified the Landlord of our termination of the Lease Agreement effective March 31, 2011, but continue to hold over in the Premises. We are currently evaluating our options with respect to remaining in or leaving the Premises. Until that evaluation is complete, we will continue to hold over in the Premises on a month-to-month basis.

9. SUBSEQUENT EVENTS

On May 7, 2012, we announced the initiation of a placebo controlled randomized Phase II clinical trial, Chien-804, to evaluate the efficacy of XIAFLEX for canines with benign subcutaneous lipomas. The single injection study will evaluate 32 dogs randomized 1:1 XIAFLEX to placebo. Auxilium has the option to license development and marketing rights to this canine lipoma indication.

In a May 9, 2012 press release, Auxilium announced that The Journal of Urology had published on its website, Auxilium’s phase IIB clinical trial of XIAFLEX for the potential nonsurgical treatment of Peyronie’s disease. Top line data from this trial had been previously reported by Auxilium. The study will be included in the June 2012 print version of The Journal of Urology.

We have evaluated subsequent events for recognition or disclosure through the time of filing these consolidated financial statements on Form 10-Q with the U.S. Securities and Exchange Commission on May 10, 2012.

Item 2: Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and the related notes thereto included elsewhere in this Report, and is qualified by reference to them.

Overview

We are a biopharmaceutical company involved in the development of an injectable collagenase for multiple indications. We are a party to the Auxilium Agreement, our development and license agreement with Auxilium for injectable collagenase (which Auxilium has named XIAFLEX® (collagenase clostridium histolyticum)) for clinical indications in Dupuytren’s contracture, Peyronie’s disease and frozen shoulder (adhesive capsulitis). Auxilium has an option to acquire additional indications that we may pursue, including cellulite, for which we have granted Auxilium the right to initiate early development studies at its cost, and human and canine lipoma. Auxilium is currently selling XIAFLEX in the U.S. for the treatment of Dupuytren’s contracture. Auxilium has an agreement with Pfizer pursuant to which Pfizer has the right to market XIAFLEX for Dupuytren’s contracture and Peyronie’s disease in Europe and certain Eurasian countries, and will do so under the registered trademark XIAPEX® (collagenase clostridium histolyticum). Pfizer is currently selling XIAPEX in nine countries in Europe, including the United Kingdom, Germany and Spain. In addition, Auxilium has an agreement with Asahi pursuant to which Asahi has the right to commercialize XIAFLEX for the treatment of Dupuytren’s contracture and Peyronie’s disease in Japan. Auxilium also has an agreement with Actelion pursuant to which Actelion has the right to commercialize XIAFLEX for the treatment of Dupuytren’s contracture and Peyronie’s disease in Canada, Australia, Brazil and Mexico.

Pursuant to the DFB Agreement, we continue to receive earn-out payments based on the sales of Santyl. Our right to receive earn-out payments with respect to the marketed topical product sold to DFB expires in June 2013, but earn-out payments for second generation collagenase products, if any, continue indefinitely.

#### Operational Highlights

In a February 23, 2012 press release, Auxilium announced that it had entered into a Collaboration Agreement with Actelion pursuant to which Actelion has the right to develop and commercialize XIAFLEX for the treatment of Dupuytren's contracture and Peyronie's disease in Canada, Australia, Brazil and Mexico. According to the release, XIAFLEX for the treatment of Dupuytren's contracture has been accepted for review by Health Canada and regulatory action is expected in the second half of 2012. Additionally, Actelion expects to file for approval of XIAFLEX for the treatment of Dupuytren's contracture in Australia, Brazil and Mexico over the next 12 months. Under the terms of the agreement with Actelion, Auxilium is to receive a \$10 million upfront payment from Actelion, as well as up to \$16 million in potential regulatory, pricing, and reimbursement milestone payments and \$42.5 million in potential sales milestone payments. Under the terms of our development and license agreement with Auxilium, we will receive a certain percentage from Auxilium in connection with the upfront payment by Actelion, and a specified percentage of any additional milestones received by Auxilium. We will also receive from Auxilium royalties from net sales and payments on costs of goods sold in Canada, Australia, Brazil and Mexico, which will be a specified percentage of what Auxilium is entitled to receive from Actelion without regard to any offset that Actelion may have with respect to Auxilium.

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On March 31, 2012, we entered into an amendment to our existing agreement, dated August 27, 2008, related to our future royalty obligations for Peyronie's disease. The amendment enables us to buy down a portion of our future royalty obligations in exchange for an initial cash payment of \$1.5 million and five additional cash payments payable upon the occurrence of a milestone event.

On May 7, 2012, we announced the initiation of a placebo controlled randomized Phase II clinical trial, Chien-804, to evaluate the efficacy of XIAFLEX for canines with benign subcutaneous lipomas. The single injection study will evaluate 32 dogs randomized 1:1 XIAFLEX to placebo. Auxilium has the option to license development and marketing rights to this canine lipoma indication.

In a May 9, 2012 press release, Auxilium announced that The Journal of Urology had published on its website, Auxilium's phase IIb clinical trial of XIAFLEX for the potential nonsurgical treatment of Peyronie's disease. Top line data from this trial had been previously reported by Auxilium. The study will be included in the June 2012 print version of The Journal of Urology.

## Outlook

Currently, we generate revenue from two primary sources: in connection with the DFB Agreement and in connection with the Auxilium Agreement. Under the DFB Agreement, our right to receive earn-out payments with respect to the marketed topical product sold to DFB expires in June 2013, but earn-out payments for second generation collagenase products, if any, continue indefinitely. Under the Auxilium Agreement, we receive sublicense income, royalties, milestones and mark-up on cost of goods sold payments related to the sale and approval of XIAFLEX/XIAPEX as described above.

## Significant Risks

We are dependent to a significant extent on third parties, and our principal licensee, Auxilium, may not be able to continue successfully commercializing XIAFLEX for Dupuytren's contracture, successfully develop XIAFLEX for additional indications, obtain required regulatory approvals, manufacture XIAFLEX at an acceptable cost, in a timely manner and with appropriate quality, or successfully market products or maintain desired margins for products sold, and as a result we may not achieve sustained profitable operations.

## Critical Accounting Policies, Estimates and Assumptions

The preparation of unaudited consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are based on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The information at March 31, 2012 and for the three months ended March 31, 2012 and 2011 is unaudited but includes all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to state fairly the financial information set forth herein. The December 31, 2011 balance sheet amounts and disclosures included herein have been derived from the Company's December 31, 2011 audited consolidated financial statements. The interim results are not necessarily indicative of results to be expected for the full fiscal year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2011 included in the Company's Annual Report on Form 10-K filed with the SEC on March 13, 2012. While our significant accounting policies are described in more detail in the notes to our unaudited consolidated financial statements, we believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our unaudited consolidated financial statements. Actual results have differed in the past, and may

differ in the future, from our estimates and could impact our earnings in any period during which an adjustment is made.

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**Revenue Recognition.** We recognize revenues from product sales when there is persuasive evidence that an arrangement exists, title passes, the price is fixed and determinable, and payment is reasonably assured. We currently recognize revenues resulting from the licensing, sublicensing and use of our technology and from services we sometimes perform in connection with the licensed technology.

We enter into product development licenses, and collaboration agreements that may contain multiple elements, such as upfront license and sublicense fees, milestones related to the achievement of particular stages in product development and royalties. As a result, significant contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple-element arrangement should be treated as separate units of accounting for revenue recognition purposes, and if so, how the aggregate contract value should be allocated among the deliverable elements and when to recognize revenue for each element.

We recognize revenue for delivered elements only when the fair values of undelivered elements are known, when the associated earnings process is complete and, to the extent the milestone amount relates to our performance obligation, when our licensee confirms that we have met the requirements under the terms of the agreement, and when payment is reasonably assured. Changes in the allocation of the contract value between various deliverable elements might impact the timing of revenue recognition, but in any event, would not change the total revenue recognized on the contract. For example, nonrefundable upfront product license fees, for product candidates for which we are providing continuing services related to product development, are deferred and recognized as revenue over the development period.

Milestones, in the form of additional license fees, typically represent nonrefundable payments to be received in conjunction with the achievement of a specific event identified in a contract, such as completion of specified clinical development activities and/or regulatory submissions and/or approvals. We believe that a milestone represents the culmination of a distinct earnings process when it is not associated with ongoing research, development or other performance on our part. We recognize such milestones as revenue when they become due and payment is reasonably assured. When a milestone does not represent the culmination of a distinct earnings process, we recognize revenue in a manner similar to that of an upfront product license fee.

### **Royalty/ Mark-up on Cost of Goods Sold / Earn-Out Revenue**

For those arrangements for which royalty, mark-up on cost of goods sold or earn-out payment information becomes available and collectability is reasonably assured, we recognize revenue during the applicable period earned. For interim quarterly reporting purposes, when collectability is reasonably assured but a reasonable estimate of royalty, mark-up on cost of goods sold or earn-out payment revenues cannot be made, the royalty, mark-up on cost of goods sold or earn-out payment revenues are generally recognized in the quarter that the applicable licensee provides the written report and related information to us.

Under the Auxilium Agreement, we do not participate in the selling, marketing or manufacturing of products for which we receive royalties and a mark-up of the cost of goods sold revenues. The royalty and mark-up on cost of goods sold revenues will generally be recognized in the quarter that Auxilium provides the written reports and related information to us, that is, royalty and mark-up on cost of goods sold revenues are generally recognized one quarter following the quarter in which the underlying sales by Auxilium occurred. The royalties payable by Auxilium to us are subject to set-off for certain patent costs.

Under the DFB Agreement, pursuant to which we sold our topical collagenase business to DFB, we have the right to receive earn-out payments in the future based on sales of certain products. Generally, under the DFB Agreement we would receive payments and a report within ninety (90) days from the end of each calendar year after DFB has sold the royalty-bearing product. Currently, DFB is providing us earn-out reports on a quarterly basis.

Consulting and Technical Assistance Services. We recognize revenues from consulting and technical assistance contracts primarily as a result of the DFB Agreement. Consulting revenues are recognized ratably over the term of the contract. The consulting and technical assistance obligations to DFB expired during March 2011.

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**Reimbursable Third Party Development Costs.** We accrued patent expenses that are reimbursable by us under the Auxilium Agreement. We capitalize certain patent costs related to estimated third party development costs that are reimbursable under the Auxilium Agreement. In August 2011, through the amendment and restatement of our development and license agreement with Auxilium, we have clarified the rights and responsibilities of the joint development of XIAFLEX. We resolved what had been an on-going dispute with Auxilium concerning the appropriate amount of creditable third party development expenses related to the lyophilization of the injection formulation and certain patent expenses for research and development costs that are reimbursable under the Auxilium Agreement. We agreed and have reimbursed Auxilium by offsetting future royalties payable for the amount invoiced us for third party development costs related to the development of the lyophilization of the injection formulation. We do not expect any additional third party development cost related to the lyophilization of the injection formulation.

As of March 31, 2012 our net reimbursable third party patent costs accrual is approximately \$15,000.

**Receivables and Deferred Revenue.** Accounts receivable as of March 31, 2012 is approximately \$1.8 million, which consists of approximately \$0.3 million due from DFB in accordance with the earn-out under the DFB Agreement and approximately \$1.5 million in royalties due from Auxilium in accordance with the terms of the Auxilium Agreement. Deferred revenue of \$0.6 million consist of licensing fees related to the cash payments received under the Auxilium Agreement in prior years and amortized over the expected development period of certain indications for XIAFLEX.

**Royalty Buy-Down.** On March 31, 2012, we entered into an amendment to our existing agreement, dated August 27, 2008, related to our future royalty obligations for Peyronie's disease. The amendment enables us to buy down a portion of our future royalty obligations in exchange for an initial cash payment of \$1.5 million and five additional cash payments payable upon the occurrence of a milestone event.

As of March 31, 2012, we have capitalized \$2.75 million related to this agreement which will be amortized over approximately five years beginning on the date of the first commercial sale of XIAFLEX for the treatment of Peyronie's disease, which represents the period estimated to be benefited using the straight-line method. In accordance with Accounting Standards Codification 350, Intangibles, Goodwill and Other, the Company amortizes intangible assets with finite lives in a manner that reflects the pattern in which the economic benefits of the assets are consumed or otherwise used up. If that pattern cannot be reliably determined, the assets are amortized using the straight-line method.

**Stock Based Compensation.** Under ASC 718, we estimate the fair value of our employee stock awards at the date of grant using the Black-Scholes option-pricing model, which requires the use of certain subjective assumptions. The most significant assumptions are our estimates of the expected volatility of the market price of our stock and the expected term of an award. Expected volatility is based on the historical volatility of our common stock. When establishing an estimate of the expected term of an award, we consider the vesting period for the award, our historical experience of employee stock option exercises (including forfeitures) and the expected volatility. As required under the accounting rules, we review our valuation assumptions at each grant date and, as a result, we are likely to change our valuation assumptions used to value future employee stock-based awards granted, to the extent any such awards are granted.

Further, ASC 718 requires that employee stock-based compensation costs be recognized over the requisite service period, or the vesting period, in a manner similar to all other forms of compensation paid to employees. The allocation of employee stock-based compensation costs to each operating expense line are estimated based on specific employee headcount information at each grant date and estimated stock option forfeiture rates and revised, if necessary, in future periods if actual employee headcount information or forfeitures differ materially from those estimates. As a result, the amount of employee stock-based compensation costs we recognize in each operating expense category in future periods may differ significantly from what we have recorded in the current period.





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RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2012 AND 2011

Revenues

Product Revenues, net

Product revenues include the sales of the collagenase for laboratory use recognized at the time it is shipped to customers. We had a small amount of revenue from the sale of collagenase for laboratory use. For the three months ended March 31, 2012 and 2011 product revenues were \$7,504 and \$5,892, respectively. This increase of \$1,612 or 27% was primarily related to the amount of material required to perform testing and additional research by our customers.

Royalties

Royalties consist of royalties and the mark-up on cost of goods sold under the Auxilium Agreement and earn-out revenues associated with the DFB Agreement. Total royalty, mark-up on cost of goods sold and earn-out revenues for the three month period ended March 31, 2012 were \$1.9 million as compared to \$0.9 million in the 2011 period, an increase of \$1.0 million or 101%. Royalty and the mark-up on cost of goods sold revenues recognized under the Auxilium Agreement were \$1.6 million for the 2012 period compared to \$0.8 million in the 2011 period. The increase was due to increased net sales of XIAFLEX during 2011 reported to us by Auxilium.

We receive earn-out revenues from DFB under the earn-out payment provision of the DFB Agreement after certain net sales levels are achieved. Revenues recognized under the DFB Agreement were \$0.3 million for the three months ended March 31, 2012 and \$0.2 million for the same period in 2011. This increase of \$0.1 million is mainly related to the increase in net sales during the 2012 period reported to us by DFB.

Licensing Revenue

Licensing revenue consists of licensing fees, sublicensing fees and milestones. For the three months ended March 31, 2012 and 2011, we recognized total licensing and milestone revenue of \$0.7 million and \$0.9 million, respectively, a decrease of \$0.2 million or 21%. Certain licensing revenues recognized are related to the cash payments received under the Auxilium Agreement in prior years and amortized over the expected development period. Licensing revenue recognized for the three months ended March 31, 2012 and 2011 was \$0.1 million in each period. Sublicensing fees recognized in 2012 were \$570,000 compared to \$750,000 in the same period in 2011. In the 2012 period, sublicensing fees recognized were related to the \$10.0 million paid to Auxilium by Actelion for the rights to develop and commercialize XIAFLEX for the treatment of Dupuytren's contracture and Peyronie's disease in Canada, Australia, Brazil and Mexico. In 2011, sublicensing fees recognized were related to the \$15.0 million paid to Auxilium by Asahi for the rights to commercialize XIAFLEX for the treatment of Dupuytren's contracture and Peyronie's disease in Japan.

Under current accounting guidance, nonrefundable upfront license fees for product candidates for which we are providing continuing services related to product development are deferred and recognized as revenue over the development period. The remaining balance will be recognized over the respective development periods or when we determine that we have no ongoing performance obligations.

Consulting Services

We recognized revenues from consulting and technical assistance contracts primarily as a result of the DFB Agreement. Consulting revenues are recognized ratably over the term of the contract. For the three months ended March 31, 2012 and 2011 consulting fees recognized were zero and \$46,667, respectively. The consulting and technical assistance obligations to DFB expired during March 2011.

#### Research and Development Activities and Expenses

Research and development expenses include, but are not limited to, internal costs, such as salaries and benefits, costs of materials, lab expense, facility costs and overhead. Research and development expenses also consist of third party costs, such as medical professional fees, product costs used in clinical trials, consulting fees and costs associated with clinical study arrangements. Research and development expenses were \$249,552 and \$212,066, respectively, for three month period ended March 31, 2012 and 2011, representing an increase in 2012 of \$37,486 or 18%. This increase in research and development expenses was primarily due to expenses related to clinical development.

We are currently working to develop XIAFLEX for the treatment of human and canine lipoma. We have designed a placebo controlled randomized study to evaluate the efficacy of XIAFLEX for the treatment of subcutaneous benign lipomas in canines. The study will consist of 32 canines randomized at 1:1 XIAFLEX or placebo. The treatment is a single injection of XIAFLEX or placebo. We initiated this trial in the second quarter of 2012. Also, we have designed a phase II dose escalation clinical study of XIAFLEX for the treatment of human lipomas. The study consists of 14 patients and four dosage groups for the treatment of benign subcutaneous lipomas. We have received FDA clearance to initiate the clinical trial and plan to do so during the second quarter of 2012.

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The following table summarizes our research and development expenses related to our clinical development programs.

Program	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011	Accumulated Expenses Since January 1, 2010
Canine Lipoma	\$ 82,291	\$ 68,417	\$ 612,538
Human Lipoma	28,278	29,705	264,268

Successful development of drugs is inherently difficult and uncertain. Our business requires investments in research and development over many years, often for drug candidates that may fail during the research and development process. Even if the Company is able to successfully complete the development of our drug candidates, our long-term prospects depend upon our ability and the ability of our partners, particularly with respect to XIAFLEX, to continue to successfully commercialize these drug candidates.

There is significant uncertainty regarding our ability to successfully develop drug candidates in other indications. These risks include the uncertainty of:

- the nature, timing and estimated costs of the efforts necessary to complete the development of our drug candidate projects;
- the anticipated completion dates for our drug candidate projects;
- the scope, rate of progress and cost of our clinical trials that we are currently running or may commence in the future with respect to our drug candidate projects;
- the scope, rate of progress of our preclinical studies and other research and development activities related to our drug candidate projects;
- clinical trial results for our drug candidate projects;
- the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights relating to our drug candidate projects;
- the terms and timing of any strategic alliance, licensing and other arrangements that we have or may establish in the future relating to our drug candidate projects;
- the cost and timing of regulatory approvals with respect to our drug candidate projects; and
- the cost of establishing clinical supplies for our drug candidate projects.

Our current resources and liquidity are sufficient to advance our significant current research and development projects and, Auxilium will have the option to exclusively license the canine and human lipoma indications upon completion of the appropriate opt-in study.

#### General and Administrative Expenses

General and administrative expenses consist primarily of salaries and other related costs for personnel, consultant costs, legal fees, investor relations, professional fees and overhead costs. General and administrative expenses were \$1,088,722 and \$1,509,526 for the three months ended March 31, 2012 and 2011, respectively, a decrease of \$420,804, or 28%, from 2011. The decrease in general and administrative expenses was due to lower general legal fees, stock based compensation and consulting services partially offset by third party royalty fees.

#### Other Income and expense

Other income for the three months ended March 31, 2012 was \$9,493 compared to \$16,560 in the 2011 period. Other income in the 2012 and 2011 periods consisted of interest earned on our investments.

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### Income Taxes

Our deferred tax liabilities, deferred tax assets and related valuation allowances are impacted by events and transactions arising in the ordinary course of business, research and development activities, vesting of nonqualified options, deferred revenues and other items. Deferred tax assets are affected by the valuation allowance which is dependent upon several factors, including estimates of the realization of deferred income tax assets, and the impact of estimated future taxable income. Significant judgment is required to determine the estimated amount of valuation allowance to record. Changes in the estimate of the valuation allowance could materially increase or decrease our provision for income taxes in future periods.

For the three month period ended March 31, 2012 income tax expense was \$0.5 million, primarily a non-cash charge. Our income tax expense for the three month period ended March 31, 2012 is based on an estimated effective tax rate derived from an estimate of consolidated earnings before taxes, adjusted for nondeductible expenses and other permanent differences for fiscal year 2012. For the three month period ended March 31, 2012, the valuation allowance with respect to our net deferred tax assets remained unchanged. As of March 31, 2012, our remaining deferred tax assets decreased by \$0.3 million to approximately \$2.8 million.

For the three month period ended March 31, 2011, the valuation allowance reversed by approximately \$3.6 million with respect to our net deferred tax assets and corresponding tax benefit reduced our statutory tax rate of 34% and resulted in net benefit of \$3.5 million. We determined that it was more likely than not that these deferred tax assets would be realized based on our projected annual profitability of operations driven by our revenues under our agreement with Auxilium. The remaining balance of deferred tax assets as of March 31, 2011 was approximately \$3.5 million.

### Net Income

For the three months ended March 31, 2012 we recorded net income of \$0.7 million, or \$0.12 per basic and \$0.11 per diluted common share, compared to a net income of \$3.7 million, or \$0.59 per basic and \$0.51 per diluted common share, for the same period in 2011.

### Liquidity and Capital Resources

To date, we have financed our operations primarily through product sales, debt instruments, licensing revenues and royalties under agreements with third parties and sales of our common stock. At March 31, 2012 and December 31, 2011, we had cash and cash equivalents and investments in the aggregate of approximately \$10.8 million and \$8.2 million, respectively.

Net cash provided by operating activities for the three months ended March 31, 2012 was \$4.1 million as compared to \$0.7 million for the same period in 2011. The change in the 2012 period as compared to the same period in 2011 was primarily attributable to a decrease in accounts receivable, and an increase in accounts payable and accrued expenses compared to the 2011 period which included the reversal of our valuation allowance resulting in the recording of a deferred tax asset.

Net cash used in investing activities for the three months ended March 31, 2012 was \$1.5 million as compared to zero for the 2011 period. The change reflects the maturing and reinvestment of \$2.0 million in marketable securities and a one-time cash payment related to our future royalty obligations for Peyronie's disease of \$1.5 million.

Net cash used in financing activities for the three months ended March 31, 2012 and 2011 was \$18,757 and zero in the comparable period of 2011. In 2012, net cash used in financing activities was mainly due to the repurchase of our

common stock under our stock repurchase program during the period partially offset by excess tax benefits related to share-based payments and proceeds received from stock option exercises.

#### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

#### Item 3: Quantitative and Qualitative Disclosures About Market Risk.

We do not use derivative financial instruments or derivative commodity instruments for trading purposes. Our financial instruments consist of cash, cash equivalents, short-term investments, trade accounts receivable, accounts payable and long-term obligations. We consider investments that, when purchased, have a remaining maturity of 90 days or less to be cash equivalents.

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We invest in marketable securities in accordance with our investment policy. The primary objectives of our investment policy are to preserve principal, maintain proper liquidity to meet operating needs and maximize yields. Our investment policy specifies credit quality standards for our investments. The maximum allowable duration of a single issue is eighteen months.

Our investment portfolio is subject to interest rate risk, although limited given the nature of the investments, and will fall in value in the event market interest rates increase. All our cash and cash equivalents and short-term investments at March 31, 2012, amounting to approximately \$10.8 million, were maintained in bank demand accounts, money market accounts, and certificates of deposit through the Certificate of Deposit Account Registry Service. We do not hedge our interest rate risks, as we believe reasonably possible near-term changes in interest rates would not materially affect our results of operations, financial position or cash flows.

We are subject to market risks in the normal course of our business, including changes in interest rates. There have been no significant changes in our exposure to market risks since December 31, 2011.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

The Company, under the supervision and with the participation of Thomas L. Wegman, the Company's President, Principal Executive Officer and Principal Financial Officer, evaluated the effectiveness of its disclosure controls and procedures as of the end of the period covered by this Report. Based on that evaluation, management has concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to the Company's management to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Furthermore, our controls and procedures can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control, and misstatements due to error or fraud may occur and not be detected on a timely basis.

#### Changes in Internal Controls

There were no changes in our internal controls over financial reporting during the three month period ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II: OTHER INFORMATION

### Item 1. Legal Proceedings

None.

### Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K filed with the SEC on March 13, 2012.



Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three month period ended March 31, 2012, we did not issue any unregistered shares of securities.

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## Issuer Purchases of Equity Securities (1)

Period	Total Number of Shares Purchased During Period (2)	Average Price Paid Per Share (3)	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Dollar Value of Shares that may yet be Purchased under the Plan (4)
January 1, 2011 – March 31, 2011	0	0	20,608	\$ 1,541,999
April 1, 2011 – June 30, 2011	8,777	\$ 23.51	29,385	\$ 1,335,651
				\$ 2,000,000 (5)
July 1, 2011 – September 30, 2011	8,981	\$ 17.18	38,366	\$ 1,845,900
October 1, 2011 – December 31, 2011	24,971	\$ 15.18	63,337	\$ 1,466,796
January 1, 2012 – March 31, 2012	12,247	\$ 16.24	75,584	\$ 1,267,935

(1) On June 4, 2010, we announced that our board of directors authorized a stock repurchase program under Rule 10b-18 of the Exchange Act of up to \$2.0 million of our outstanding common stock over a period of 12 months. On June 20, 2011, we announced that our Board of Directors had reauthorized this stock repurchase program.

(2) The purchases were made in open-market transactions.

(3) Includes commissions paid, if any, related to the stock repurchase transactions.

(4) Represents the difference between the original \$2.0 million of stock repurchases authorized by our board of directors on June 4, 2010 less the value of the stock repurchased for the indicated period.

(5) On June 20, 2011, our board of directors reauthorized the repurchase of up to \$2.0 million of our common stock under the stock repurchase program.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. (Removed and Reserved).

## Item 5. Other Information

None.

## Item 6. Exhibits

3.1 Registrant's Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of the Registrant's Form 10-KSB filed with the SEC on March 2, 2007).

3.2 Registrant's Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 of the Registrant's Form 10-KSB filed with the SEC on March 2, 2007).

31\* Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).

32\* Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

\* filed herewith



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

BIOSPECIFICS TECHNOLOGIES CORP.  
(Registrant)

Date: May 10, 2012

/s/ Thomas L. Wegman  
Thomas L. Wegman  
President, Principal Executive Officer and Principal Financial  
Officer