



Vyaderm Pharmaceuticals

In 1999 we threw out the old executive compensation system altogether and introduced EVA. It was meant to be symbolic—a cathartic change.

—Maurice Védrine

Danielle Sanders and Blake Myers checked their calculations once again. In one hour they had to update Vyaderm Pharmaceuticals' CEO on the implementation of Economic Value Added. They faced a difficult decision about what to recommend for the bonus and performance target for the Dermatology division.

New Leadership

Vyaderm Pharmaceuticals, founded in 1945, was headquartered in Seattle, Washington. Deriving most of its initial revenues from the manufacture of drugs such as penicillin, the company grew rapidly as the postwar healthcare system evolved. By 1996 Vyaderm was a \$2.7 billion company, with 17,500 employees organized in 15 subsidiaries worldwide. Generic pharmaceutical products generated 75% of Vyaderm's revenue; patent-protected and branded products accounted for the rest. Major therapeutic areas included dermatology, gastroenterology, and veterinary drugs.

In 1997, Vyaderm's CEO, Thomas E. Finn, retired. Finn had been CEO for 18 years and was widely credited for having built Vyaderm to its current market position. The board named Maurice Védrine, at the time 41 years old and the president of the European division, to be Finn's successor. Védrine had an MBA from INSEAD and 15 years of operational experience both in Europe and the United States. Védrine faced a problem that was not unusual for new CEOs succeeding successful leaders. He wanted to imprint his vision and strategy on the business, but was unable to criticize directly the decisions of his highly-regarded predecessor.

Védrine worried that the 15 subsidiaries—all operating in related segments of the pharmaceutical market—were being run as fiefdoms. There was little sharing of best practice or interest in helping build synergies to support corporate strategy. The question was, how could these divisions work together to fuel continuing profitable growth?

Tom Finn, Védrine's predecessor, had run the business by a singular focus on earnings per share. "Make the numbers or else" was the unspoken operating rule throughout the company—driven in large part by Finn's insistence that the company consistently meet analysts' expectations.

Research Associate Indra A. Reinbergs prepared this case under the supervision of Professor Robert Simons as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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However, profitability had begun to slip in many of the business divisions, and Védrine was under considerable pressure to perform.

Economic Value Added

In late 1997, Védrine turned to a prominent consulting firm for help in implementing Economic Value Added (EVA¹). Védrine believed that EVA was a "ruthlessly objective," comprehensive performance measure that would "get people off Wall Street's focus on earnings per share and thinking more long term." EVA was intended to become the sole financial measure at Vyaderm.

To design and implement the new EVA system, Védrine enlisted the help of Chief Financial Officer Danielle Sanders and Controller Blake Myers. Sanders had joined Vyaderm from Deloitte & Touche in 1984 as director of financial planning for the North American division, and became corporate controller in 1995. Myers had worked previously at the University of Washington, joined Vyaderm as manager of corporate financial planning in 1981, and in 1994 became vice president of operations for the North American division. Myers succeeded Sanders as controller in 1995, when Sanders was named chief financial officer.

While Védrine saw EVA as a way to demonstrate to the investment community that he intended to continue Vyaderm's profitable growth, Sanders and Myers also saw it as a solution to conflicting management priorities caused by competing financial measures such as cash flow (for valuing acquisitions) and return on sales (for paying bonuses).

EVA Calculations and Adjustments

EVA was a reincarnation of the traditional accounting concept of residual income, which measured the extent to which a company's after-tax operating profits covered the shareholder's cost of capital. General Motors developed a residual income system in the 1920s for measuring the performance of operating divisions, and the practice was continued by such companies as General Electric into the 1960s, after which the concept faded from popular memory.

Consultants Stern Stewart & Company revived the residual income concept in the early 1990s. They argued that, by holding managers accountable for the capital provided by investors, EVA was the best way to align the interests of divisional managers, the company, and shareholders. Of three traditional measures of performance—earnings per share, return on investment, and discounted cash flow—only the discounted cash flow method took into account the cost of capital (through the discount rate). Similarly, with EVA only investments with a positive economic return (i.e., a return greater than the cost of capital) were likely to be pursued.

The formula for EVA was:

$$\text{EVA} = \text{Net Operating Profit after Taxes} - [\text{Capital} \times \text{Cost of Capital}]$$

¹ Consultants Stern Stewart & Company have trademarked "EVA" as their name for residual income.

As Vyaderm described the concept in its 1999 annual report,

EVA is a tool which simply yet effectively combines the income statement and balance sheet into one number, by subtracting from earnings a charge for the utilization of assets employed in generating those earnings.

To strengthen the correlation between short-term accounting income based on Generally Accepted Accounting Principles (GAAP) and changes in true economic value, Stern Stewart & Company offered a list of accounting adjustments to transform accounting income into EVA. For example, under the theory that any current period expenditure that creates future value should be treated as an asset, expenditures for items such as goodwill and R&D were capitalized in the EVA calculations, and the income statement and balance sheet were increased correspondingly. Although Stern Stewart offered over 160 possible adjustments, EVA companies typically used less than seven adjustments, both for ease of calculation and to maximize understanding and acceptance of EVA by managers.²

Vyaderm adjusted only four accounts in calculating EVA: research and development, consumer advertising, goodwill, and restructuring charges (i.e., unusual profit & loss items such as asset write-offs).

1. Under U.S. GAAP, *research and development* expenditures were normally treated as an expense. For EVA calculations, R&D was instead capitalized and amortized on a straight-line basis over 5 years.
2. For EVA calculations, *consumer advertising* expenses were capitalized and amortized on a straight-line basis over three years. Capitalized advertising was added to net operating assets, and the current year's expense was added back to operating earnings.
3. Under U.S. GAAP, *goodwill* from acquisitions was amortized on a straight-line basis for periods up to 40 years. For EVA calculations, this accounting entry was reversed. Cumulative goodwill that had been amortized to date was added to net operating assets, and the current year's amortization was added back to operating earnings.
4. Finally, for EVA purposes *restructuring* expenses were removed from the profit and loss statement and added back to net operating assets.

See Exhibit 1(a) for a summary of Vyaderm's EVA calculations and Exhibit 1(b) for an R&D amortization example.

EVA Incentive Program

Under the old compensation system, approximately 1,000 managers received an annual bonus. Half the bonus was based on objective operating results (such as business unit sales, earnings, and asset management); the other half of the bonus depended on a subjective evaluation of the manager's personal contribution.

As Danielle Sanders (CFO) described the old compensation system:

² S. David Young, "Some Reflections on Accounting Adjustments and Economic Value Added," *Journal of Financial Statement Analysis*, Winter 1999, pp. 7-19.

Tom Finn introduced a subjective piece so people always got something in bad years, even if they didn't perform. Unfortunately, sometimes people spent more time negotiating the subjective part of their bonus than worrying about profit. Bonuses were generally withheld only from managers who were 'out of favor.' Annual bonuses were handed out in person in the form of a check, and there was no explanation as to how the bonus amounts had been calculated. Furthermore, no one questioned this operating style.

In accordance with Maurice Védrine's desire to drive more objectivity into the performance evaluation and compensation system, EVA was to be the centerpiece of bonus compensation.

The EVA program introduced at Vyaderm for 1999 had three elements: EVA centers, EVA drivers, and an EVA-based incentive program. An EVA center represented a separate business unit with its own balance sheet and income statement. EVA drivers were operational practices that improved EVA results. For example, three key EVA drivers were profitable growth (e.g., extending product lines or purchasing new businesses), operating efficiencies (e.g., reducing fixed or variable costs), and utilization of assets (e.g., reducing inventory or divesting unprofitable businesses).

The third element of Vyaderm's program was a variable compensation, EVA-based incentive program. For each manager, a target EVA bonus was set. The payout of the target bonus depended on the performance of the relevant EVA center(s) to which the manager was assigned, and possibly other EVA drivers, depending on how goals were weighted.

Vyaderm's board of directors set an EVA target and EVA performance interval for each of Vyaderm's EVA centers. The EVA target was based on the expected improvement in EVA from one year to the next. This was the measure upon which most management attention was focused. The EVA interval was the shortfall from target that eliminated the bonus altogether. In line with the EVA philosophy of continuous improvement, the dollar value of the expected EVA improvement and the interval were usually kept constant from year to year. Exhibit 2 depicts graphically Vyaderm's EVA incentive calculation.

An important feature of EVA was the unlimited upside and downside of an individual manager's bonus potential, creating a strong performance incentive (see Exhibit 3). A manager's target bonus was set as a fixed percentage of base pay, ranging from 40% for middle managers to 90% for the CEO. A bonus bank ensured that EVA improvements were sustained over time before awards were fully paid out.

The first step in computing annual bonuses was to calculate the division's actual EVA improvement over the previous year, adjusted for the expected EVA improvement goal and interval.

The second step was to determine the bonus payout for the year. If EVA goals were fully achieved, the company would credit the full amount of the bonus—plus any additional amount due to results in excess of the EVA goal—to the bonus bank. From this "bank balance" the manager was paid the target bonus plus one-half of any remaining balance (due either to superior performance in the current year, or to the carry-forward of balances from previous years).

A decline in EVA performance reduced the amount of bonus credited to the bank. If EVA performance fell below the EVA interval, a negative entry was made to the bonus bank, which would reduce the bank balance as well as future rewards. However, if sufficient funds existed, a manager was still eligible to draw down the balance in the bank in an amount equal to the target bonus plus one-half of any balance from previous years. (See Table A on the next page for an example of this calculation.)

A separate bonus bank was created for each individual manager. If a manager changed divisions within Vyaderm, the bonus bank would follow the manager. However, if the manager

voluntarily left the company, the balance in the bonus bank was forfeited. As Vyaderm's proxy statement stated, "this bonus bank creates short- and long-term incentive features, rewarding sustained performance and continued employment."

Table A Sample Bonus Calculation

The following example illustrates the effect on bonuses of EVA performance above and below the EVA target:

Assumptions:

- Manager's Base Pay: \$100,000
- Target Bonus: 40% of base pay = \$40,000
- EVA Improvement Goal \$ 5 million
- EVA Interval \$ 15 million
- Calculated Bonus = Target Bonus x EVA Performance
- EVA Performance = $1 + [(Actual\ Improvement - Improvement\ Goal) / Interval]$

Year One: Actual EVA Improvement = \$10 million (Performance Above EVA Target)	Year Two: Actual EVA Improvement = -\$11 million (Performance Below EVA Target)
Beginning Bank Balance = \$0	Beginning Bank Balance = \$6,667
1. Calculated Bonus = Target Bonus x EVA Performance = \$40,000 x [1 + [10 million - 5 million]/15 million] = \$40,000 x 1.33 = \$53,333 New Bank Balance = \$0 + 53,333 = \$53,333	1. Calculated Bonus = Target Bonus x EVA Performance = \$40,000 x [1 + [-11 million - 5 million]/15 million] = \$40,000 x [-.067] = -\$2,667 New Bank Balance = \$6,667 - 2,667 = \$4,000
2. Payout = Target Bonus + 50% Remaining Balance (but not to exceed balance in bank) = \$40,000 + 0.5 [53,333 - 40,000] = \$46,667 Ending Bank Balance = \$6,667	2. Payout = Target Bonus + 50% Remaining Balance = \$40,000 + 0.5 [4,000] (but not to exceed \$4,000 balance in bank) = \$4,000 Ending Bank Balance = \$0

As the example illustrates, in the first year of an EVA incentive program managers had no bonus bank to fall back on if the first year's EVA results fell below expectations.

Redesigning the Organization

In 1996, Vyaderm was organized primarily by geography: subsidiaries were incorporated in 10 countries outside the United States. Within the United States, Vyaderm operated 5 different business units.

Each business unit had its own profit and loss statement and operating goals. However, there was no capital charge for assets on the business unit's balance sheet. In fact, many business units did not have complete balance sheets. As Myers recalled, "This lack of balance sheet

accountability was visible in capacity planning. Everything was free. There was too much cash tied up in the business. As businesses matured and products became commodities, margins began to decline."

Under Tom Finn, financial targets were set at corporate headquarters. As long as the general managers of each country met their numbers, they were given a great deal of independence in implementation. As a result, there was not much horizontal communication between businesses.

In 1998, when Védrine initially began thinking about introducing EVA, he wanted to organize on a global product basis and base 100% of the bonuses of the 1,000 managers on corporate EVA. In effect, this would create a single EVA center. However, this proposal ran into strong resistance from the business units. Division managers argued to maintain performance measures that they could control more directly. The further away managers were located from Seattle, the more they lobbied for "line of sight" performance measures, based on EVA drivers such as sales growth, rather than corporate EVA. (See Exhibit 4 for a list of EVA drivers.)

To placate the regional managers, Sanders and Myers made several initial design choices. Each separate business unit became an EVA center, so that in 1999 there were 15 separate EVA centers. (See Exhibit 5 for changing organizational structure from 1996 to 2000.) There were now to be 7 global product EVA centers (ranging from the antifungal to the nutraceutical business), 7 regional centers (from the United States to South Asia), and the corporate EVA center in Seattle. Furthermore, to ease the transition from the old bonus system, most participants, such as global business staff and regional staff, would have only 75% of their 1999 bonus based on their EVA center's results. The remaining 25% representing individual or team goals would be based on EVA drivers, which allowed for some subjectivity. The head of the manager's global business unit set the individual drivers. (See Exhibit 6 for 1999 goal weights). For middle managers earning between about \$60,000 and \$80,000, the EVA bonus was the largest part of their total compensation package.

The Diagnostic Adjustment

In 1999, the first year of the EVA program, the Diagnostic business had an unexpectedly bad year. Under the new EVA program, the shortfall would be posted as a deficit to the bonus bank—wiping out the potential for future bonuses for one or more years. Védrine faced a dilemma. He worried greatly about demotivating managers at the outset of the program. But he was very reluctant to ask Vyaderm's board members to adjust the initial EVA calculation, since he had assured them that there would be no exceptions. In the end, the board members agreed to wipe the slate clean for Diagnostic, give a very small bonus, and not apply the EVA calculation in the first year of the program. Sanders later admitted, "Resetting the Diagnostic goal back to zero set a bad precedent, because then other people said, 'Why not do it for us?'"

On reflecting back on the company's experience with the 1999 EVA plan, Myers (controller) stated,

We were foolish to agree to do the 15 EVA centers in 1999. Fifteen EVA centers were too much to manage. For EVA to work you need a full balance sheet. With Vyaderm's multinational operations, it was difficult to restate profit and loss statements in constant U.S. dollars; balance sheets of regional EVA centers were incomplete; and there were transfer pricing issues. We were fabricating goals and intervals for 15 EVA centers.

Streamlining EVA

Based on this experience, Védrine, Sanders and Myers decided to drastically reduce the number of EVA centers from 15 to 4 and reorganize the company along a sector structure. Thus, at the beginning of 2000, Vyaderm was reorganized into three global businesses (Dermatology, Internal Medicine, and Veterinary Medicine), run across four geographic regions (North America, Europe, Asia, and Latin America). Each global group was an EVA center, plus the corporate headquarters in Seattle. Each of the four EVA centers had its own EVA target and calculation.

The global sector heads developed strategic global operating plans, which the regional heads of North America, Europe, Asia, and Latin America implemented and customized in the context of an annual operating plan that they developed for their region. EVA targets for each EVA center were to be cascaded down to the individual operating units that comprised the division. For corporate officers, bonuses were based 100% on corporate EVA, while their direct reports were compensated on a mix of corporate EVA, business unit EVA, and individual or team EVA goals.

The Dermatology Opportunity

The Global Dermatology business was the smallest of the three global businesses, providing 20% of corporate revenues. Because of Vyaderm's recent reorganization into global product groups, fiscal 2000 was the first year that Global Dermatology was set up as a separate EVA center. Like all Vyaderm businesses, Dermatology was committed to achieving a consistent annual EVA improvement over the next three years.

Janine Vachon was the president of Global Dermatology. After building up the U.S. business to profitability, Vachon spent three years in Paris, France, consolidating the operations of the European division. Vachon described her evolving views of EVA,

Although I was always a strong believer in 'line of sight' performance measures, I recognized that in the early 1990s we ran our own fiefdoms and didn't talk to anybody. Over two years I became a convert to Maurice's view about the importance of EVA, and tried convince the other two global business heads to implement EVA more fully.

Just as the new EVA program was being rolled-out in January 2000, a unique competitive opportunity arose. Vyaderm was the U.S. market leader in generic antifungal creams, with a market share of over 50%. Its main competitor was PJL Laboratories, which had a 25% market share. Competition between Vyaderm and PJL in this generic market was fierce. Without patent protection or other ways of differentiating their products, the two combatants were engaged in a fierce price war. As a result, margins were razor-thin, and profits were low.

In December 1999, agents of the Food and Drug Administration (FDA) unexpectedly seized all of the products at PJL for violations of quality standards. (It was later revealed that the FDA had been investigating PJL for several years.) As Vachon described the situation, "Investing in technology is crucial to meet FDA standards. Because of low margins, PJL just wasn't able to invest as much as needed to remain FDA-compliant and still compete." As a result of the FDA action, PJL's production facility was shut down, and over a million tubes of its topical antifungal solution were recalled. Until the FDA allowed PJL to resume production, this situation suddenly left Vyaderm as the dominant supplier of antifungal cream for the entire U.S. market.

The change in the competitive situation would enable the U.S. dermatology business to temporarily raise prices to normal levels and thereby boost its profit margin substantially.

Vyaderm's employees began gearing up production to take advantage of the opportunity, which managers knew could be short-lived. While it was not certain that PJI would regain FDA approval, other generic manufacturers were certain to enter the market to capture the profit potential. In the meantime, all available resources were to be dedicated to ramping up production—and profits.

January 2001

Danielle Sanders and Blake Myers were preparing to meet with Maurice Védrine. As they had anticipated, 2000 profits for the Dermatology business had greatly exceeded the EVA target. But, as expected, a new competitor had entered the generic antifungal business late in the year, causing profits to fall back to historical levels. The two officers would have to make a recommendation regarding the 2000 EVA bonus for the North American Dermatology business. Should the target be adjusted to reflect the "windfall" created by the exit of PJI from the generic market place? Arguments could be made both ways.

In theory, the new EVA plan was supposed to have unlimited upside potential. Under this view, the divisional managers should receive a full bonus for the unexpectedly high profits. For example, if the exit of PJI from the market enabled Vyaderm to exceed its EVA target by 300%, then in 2000 the managers would receive 100% of their target bonus plus half of the excess (150%), with the remainder being banked. If in 2001 the Dermatology business then underperformed its new, substantially higher EVA target by 200%, the negative 200% would "wipe out" the positive balance in the bonus bank. As a result, the managers would receive no bonus for 2001, and have no cushion for 2002. Moreover, EVA performance might not rise to 2000 levels for several years into the future.

Still, managers would have the benefit of receiving a lump sum early.

Sanders and Myers wondered if they should adjust the EVA results since this was clearly a one-time competitive situation. Sanders turned to Myers, "I'm afraid that negative EVA results in Dermatology for years into the future will affect staff morale, causing good managers to leave the division and hurt efforts to recruit new hires who will not have a bonus bank to fall back on. But the real problem is human psychology. The emotional roller coaster will be ridiculous. You will never change the psychological impact of winning big this year and performing poorly the next."

Using data from Exhibit 8, Sanders and Myers began to prepare their recommendation. Since this was the first year of the EVA program for the newly formed Dermatology division, Maurice Védrine had asked them to calculate:

1. 2000 EVA for the North American Dermatology division
2. 2000 EVA bonus payout for a manager earning \$200,000, assuming that the manager's bonus was based 100% on the division's EVA
3. 2001 EVA and estimated bonus payout for the same manager, assuming that Vyaderm profits fell back to historical levels and the year-to-year EVA improvement goal remained constant

With these calculations in hand, and aware of the recent pressure on stock prices (Exhibit 7), Sanders and Myers would make their recommendation to Maurice Védrine.

Exhibit 1(a) Components of Vyaderm's EVA formula

<u>NET OPERATING PROFIT AFTER TAXES</u>	<u>CAPITAL</u>
Operating Earnings	Net Operating Assets (NOA)
+ R&D expense reported on P&L ①	+ Capitalized research & development ③
- R&D amortization for EVA adjustment ②	(less accumulated amortization)
+ Advertising expense reported on P&L	+ Advertising expense
- Advertising amortization for EVA adjustment	(less accumulated amortization)
+ Goodwill amortization add-back	+ Accumulated amortization of goodwill
+ Restructuring add-back	+ Restructuring add-back
= Net Operating Profit Before Taxes (NOPBT)	= Capital
- Taxes (based on actual payments)	
= Net Operating Profit After Taxes (NOPAT)	

Exhibit 1(b) Sample Schedule of R&D Amortization for 1999 EVA Adjustment

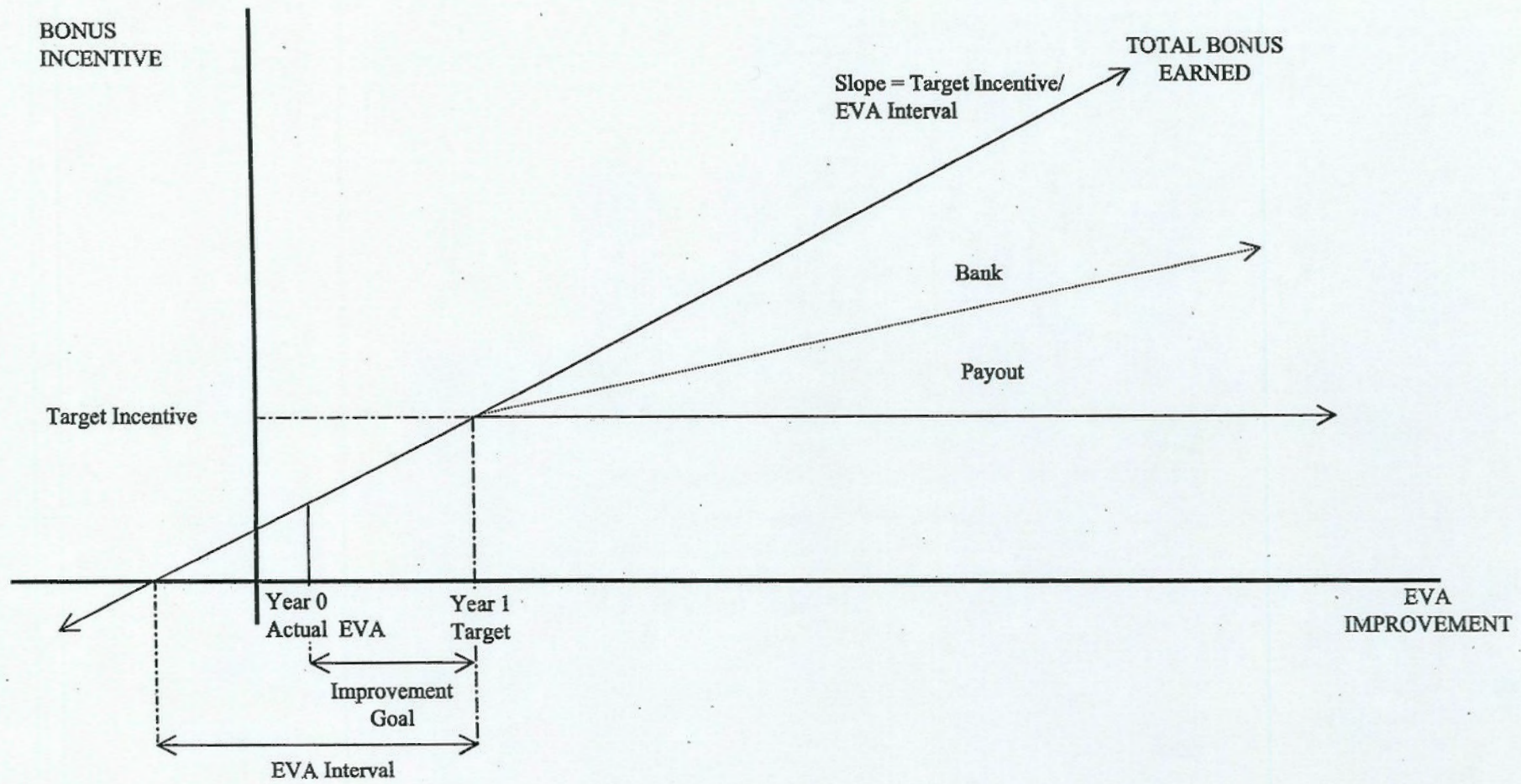
▼
(first year of program)

	1995	1996	1997	1998	1999	
R&D Expense as Reported on P&L	\$ 1,500	\$ 2,200	\$ 2,600	\$ 3,100	\$ 3,700	①
Amortization for						
EVA Adjustment						
1995	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	
1996		\$ 440	\$ 440	\$ 440	\$ 440	
1997			\$ 520	\$ 520	\$ 520	
1998				\$ 620	\$ 620	
1999					\$ 740	
1999 R&D Amortization under EVA					\$ 2,620	②
Cumulative R&D Expense (P&L)	\$ 1,500	\$ 3,700	\$ 6,300	\$ 9,400	\$ 13,100	
Less: Cumulative Amortization (EVA)	\$ 300	\$ 1,040	\$ 2,300	\$ 4,180	\$ 6,800	
Capitalized R&D for 1999 EVA Calculation of Capital					\$ 6,300	③

Notes:

- ① = Amount added back to P&L
 ② = Amount subtracted from P&L
 ③ = Amount added to Capital (Balance Sheet)

Exhibit 2 EVA Incentive Plan



Note: The EVA interval is the shortfall from target that eliminates the bonus. An EVA center's performance (%) = $1 + [(\text{actual improvement} - \text{improvement goal}) / \text{EVA interval}]$

Exhibit 3 Excerpt from Vyaderm Executive Presentation Explaining the Merits of EVA

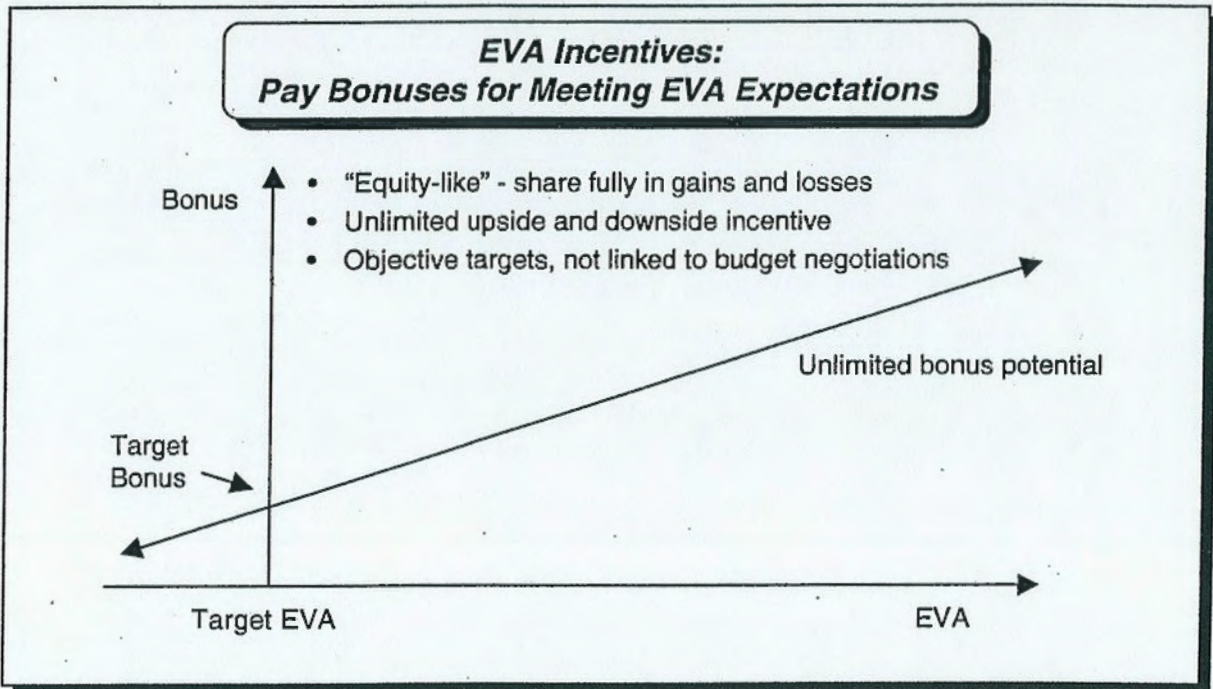
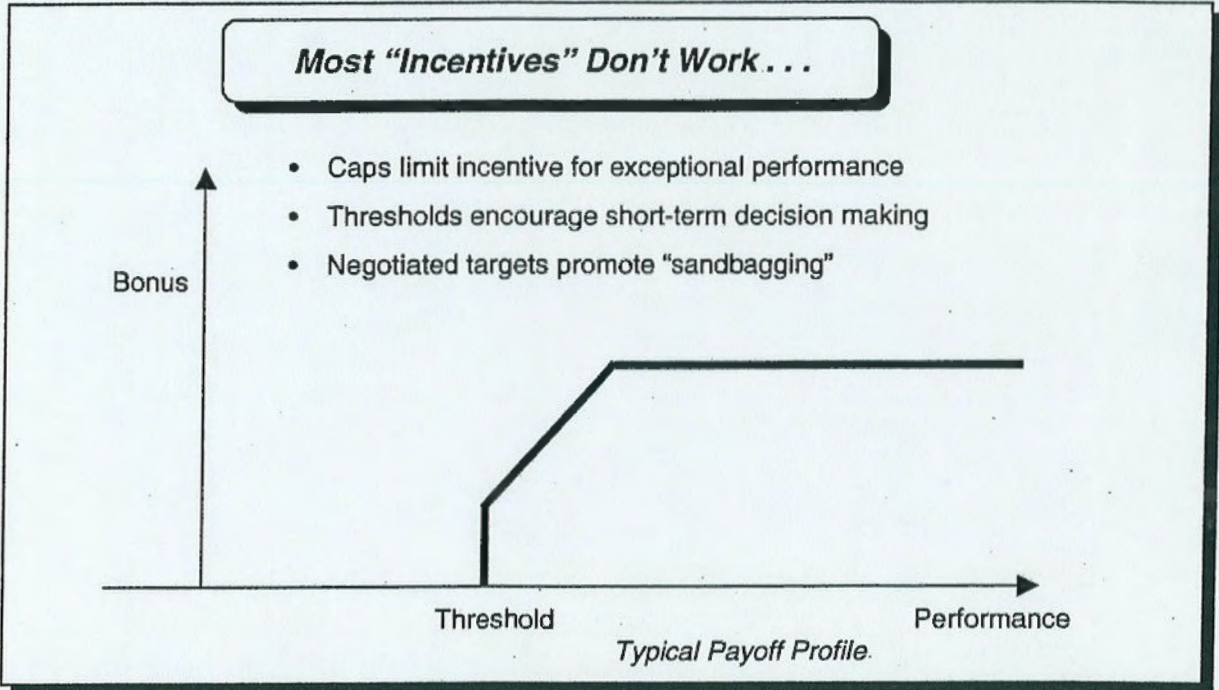
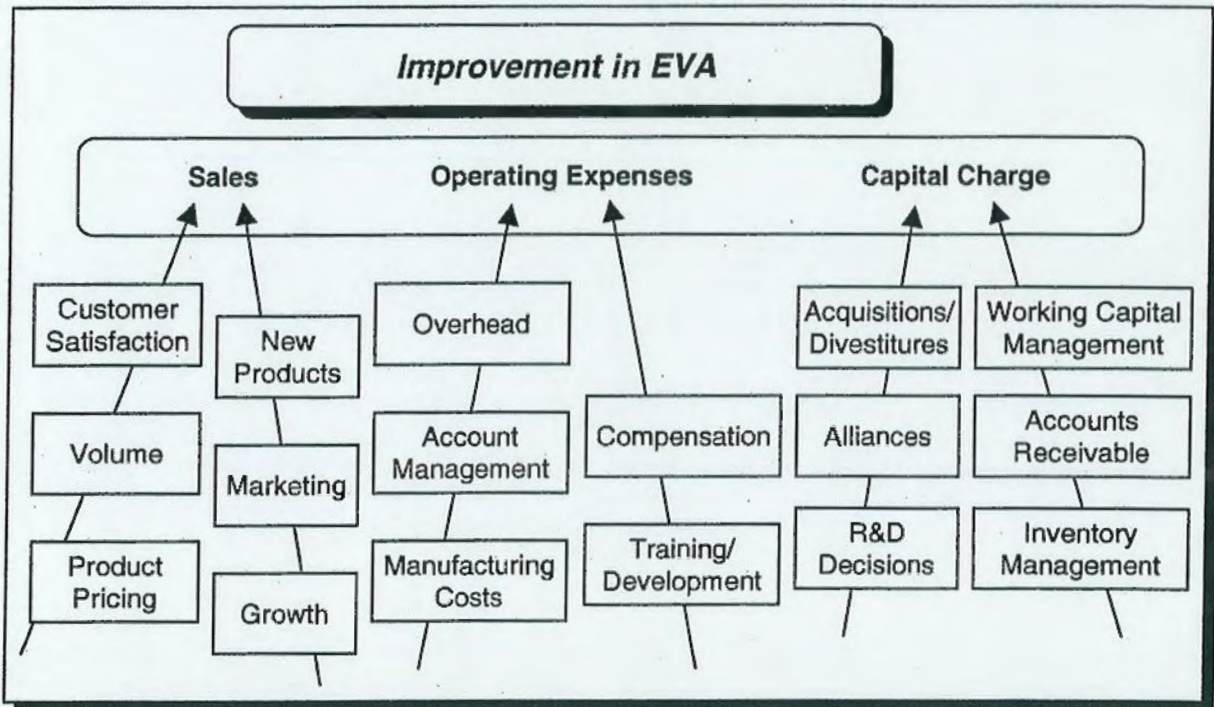


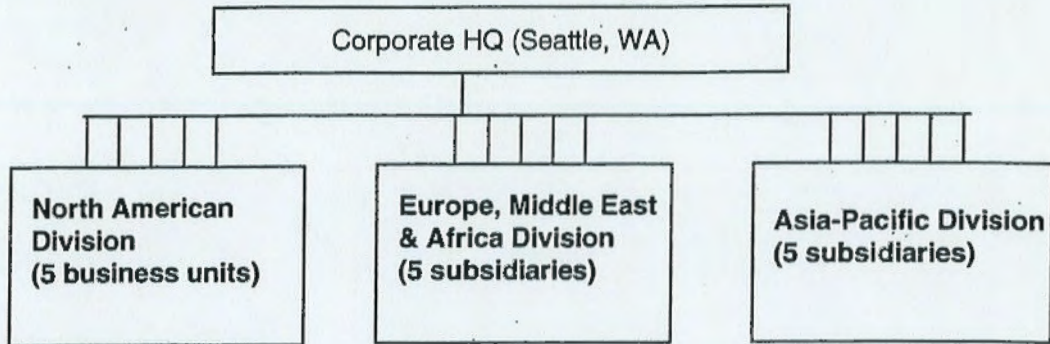
Exhibit 4 EVA Drivers



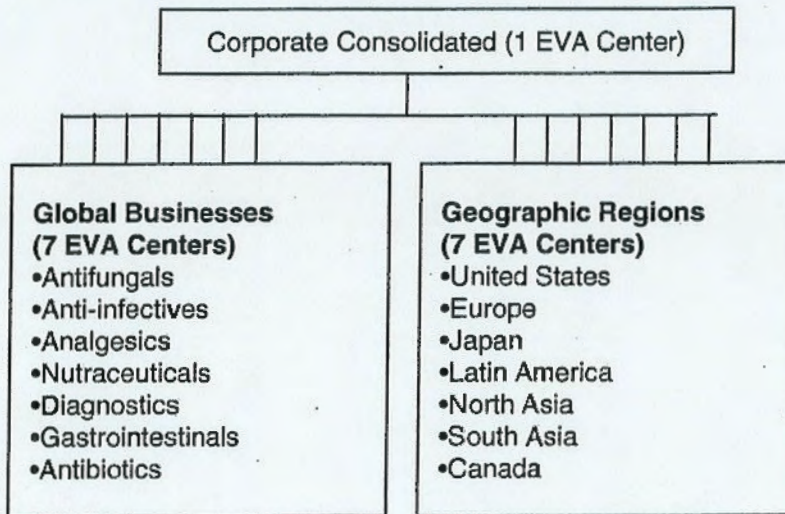
<p>Manufacturing EVA Drivers</p> <ul style="list-style-type: none"> • Reduce Inventory • Reduce Cycle Time • Improve Yields • Reduce Scrap/Waste • Maximize Labor Efficiencies • Improve Vendor Efficiencies • Process Improvements 	<p>Research & Development EVA Drivers</p> <ul style="list-style-type: none"> • Improve "To-Market" process • Reduce R&D expenses as % of New Product Sales • Strategic partners for R&D • Stronger Links to Product Marketing • New Products via: <ul style="list-style-type: none"> - Research - Formulation - Development - Acquisition
<p>Staff EVA Drivers</p> <ul style="list-style-type: none"> • Work Group/Process Simplification • Consistency "Monitors"—Audit • Centralizing Resources/Synergies • Best Practices Benchmarking • Insourcing/Outsourcing Decisions • Simplify EVA Measurements/Reporting • Ensure Compliance with Legislation 	<p>Marketing EVA Drivers</p> <ul style="list-style-type: none"> • Increase Market Share/ Revenue • New Markets • More Focused Channel Programs • Voice of Customer/Consumer • Leverage Advertising/Promotion • Build Brand Awareness

Exhibit 5 Vyaderm Changing Organizational Structure

1996 Organizational Structure (15 Profit & Loss Subsidiaries)



1999 Organizational Structure (15 EVA Centers)



2000 Organizational Structure (4 EVA Centers)

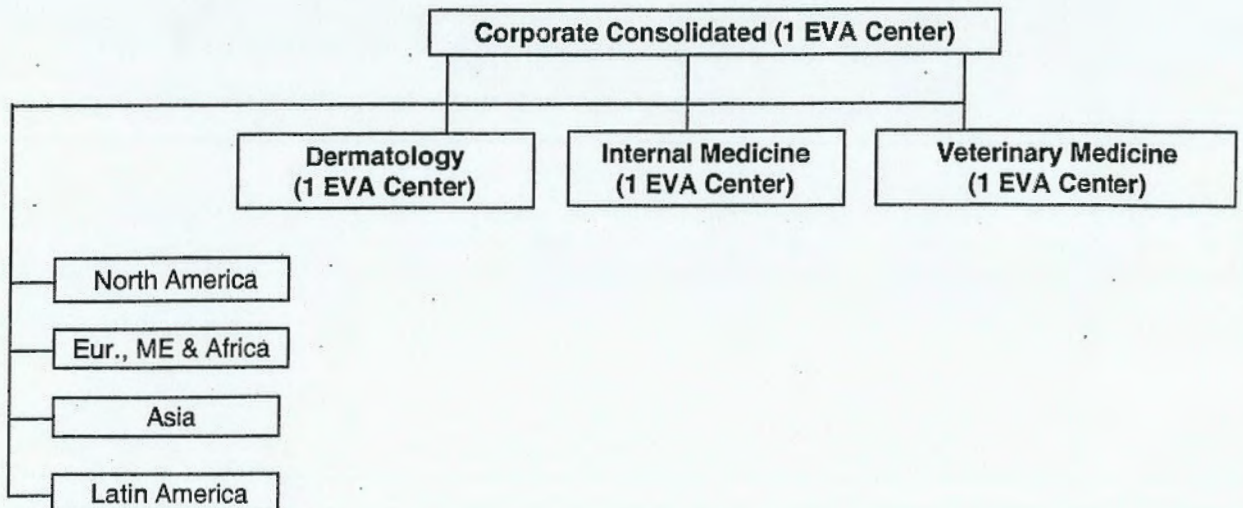


Exhibit 6 Goal Weights - Transition Year (1999)

	Corporate EVA	Business Unit EVA	Global Business EVA	Region EVA	EVA Drivers
Corporate					
9 Management Committee Officers (includes 3 global product heads)	100%				
Staff Officers	100%				
Corporate Staff	75%				25%
Global Business					
Global Business Staff			75%		25%
Regions					
Regional Division President			50%	50%	
Regional Marketing Heads			50%	50%	
Regional Staff				75%	25%
Country Managers & Controllers				50%	50%
Commercial Directors				50%	50%
Free Standing Businesses					
Presidents	25%	75%			
Staff		75%			25%

Exhibit 7 Vyaderm Stock Performance

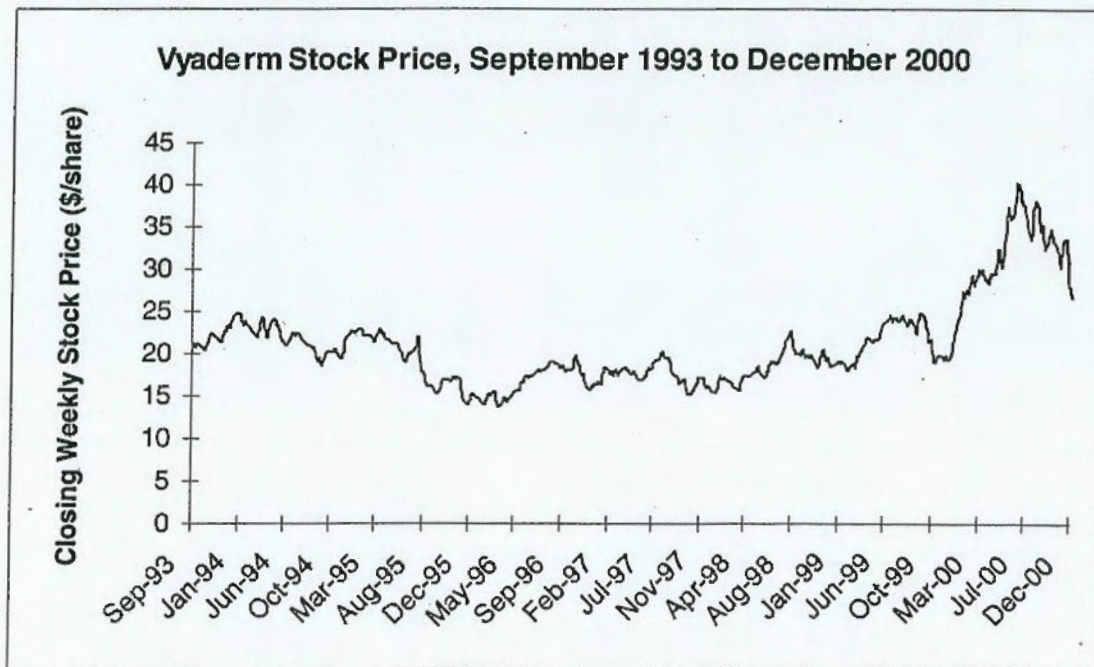


Exhibit 8 North American Dermatology Financial Data for EVA Calculation

(\$ 000s except bonus)	1996	1997	1998	1999	2000
Divisional EVA Calculation:					
Actual EVA				\$ 2,920 (a)	
EVA Improvement Goal					\$ 2,150
EVA Target					\$ 5,070
EVA Interval					\$ 12,000
Profit & Loss:					
Income before following items:	\$ 24,694	\$ 31,512	\$ 36,584	\$ 42,545	\$ 92,550
Research & Development Expense	12,487	14,610	17,094	20,000	39,000
Consumer Advertising Expense	34	38	41	45	50
Goodwill Amortization	0	2,500	2,500	2,500	2,500
Net Income Before Tax	\$ 12,173	\$ 14,364	\$ 16,949	\$ 20,000	\$ 51,000
Current Year's Income Tax Payments	(4,260)	(5,902)	(6,807)	(7,875)	(18,725)
Balance Sheet:					
Net Operating Assets	\$ 66,949	\$ 79,000	\$ 93,220	\$ 110,000	\$ 135,000
From Footnotes:					
Accumulated Goodwill Amortization	\$ 0	\$ 2,500	\$ 5,000	\$ 7,500	\$ 10,000
Capital Charge for EVA Purposes					11%
Divisional Manager's Bonus:					
Base Salary				\$ 200,000	\$ 200,000
Bonus Target				n.a.	60%
Bonus Payout				\$ 60,000	

Note:

(a) EVA was introduced in the Dermatology division for the first time in 2000. The 1999 EVA figure was calculated retroactively solely to set 2000 EVA targets. The 1999 EVA calculation includes the amortization of a 1995 R&D expense of \$10,673.