LANNETT CO INC
Form 10-Q
February 03, 2017
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2016

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

FOR THE TRANSITION PERIOD FROM TO

Commission File No. 001-31298

LANNETT COMPANY, INC.

(Exact Name of Registrant as Specified in its Charter)

State of Delaware	**23-0787699**
(State of Incorporation)	(I.R.S. Employer I.D. No.)

9000 State Road

Philadelphia, PA 19136

(215) 333-9000

(Address of principal executive offices and telephone number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each class of the registrant s common stock, as of the latest practical date.

Class	**Outstanding as of January 31, 2017**
Common stock, par value $0.001 per share	37,189,492

Table of Contents

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LANNETT COMPANY, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	(Unaudited) December 31, 2016	June 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 247,253**	$ 224,769
Investment securities	**11,870**	14,094
Accounts receivable, net	**222,986**	211,722
Inventories	**130,238**	114,904
Deferred tax assets	**45,375**	40,892
Other current assets	**7,886**	6,434
Total current assets	**665,608**	612,815
Property, plant and equipment, net	**227,053**	216,638
Intangible assets, net	**470,065**	575,503
Goodwill	**339,566**	333,611
Deferred tax assets	**31,782**	11,556
Other assets	**18,848**	13,895
TOTAL ASSETS	**$ 1,752,922**	$ 1,764,018
LIABILITIES		
Current liabilities:		
Accounts payable	**$ 43,772**	$ 34,720
Accrued expenses	**11,662**	9,247
Accrued payroll and payroll-related expenses	**8,910**	10,572
Rebates payable	**36,785**	21,894
Royalties payable	**3,550**	5,127
Restructuring liability	**5,347**	4,130
Settlement liability	**8,000**	7,000
Income taxes payable	**1,483**	743
Acquisition-related contingent consideration	**35,000**	35,000
Short-term borrowings and current portion of long-term debt	**178,239**	178,236
Total current liabilities	**332,748**	306,669
Long-term debt, net	**867,221**	883,612
Settlement liability	**9,167**	12,526
Other liabilities	**7,136**	6,754
TOTAL LIABILITIES	**1,216,272**	1,209,561
Commitments and Contingencies (Note 13 and 14)		
STOCKHOLDERS EQUITY		
	37	37

Common stock ($0.001 par value, 100,000,000 shares authorized; 37,443,721 and 37,150,165 shares issued; 36,838,519 and 36,604,202 shares outstanding at December 31, 2016 and June 30, 2016, respectively)				
Additional paid-in capital		**288,906**		283,301
Retained earnings		**257,119**		278,355
Accumulated other comprehensive loss		**(257)**		(295)
Treasury stock (605,202 and 545,963 shares at December 31, 2016 and June 30, 2016, respectively)		**(9,155)**		(7,349)
Total Lannett Company, Inc. stockholders equity		**536,650**		554,049
Noncontrolling interest				408
Total stockholders equity		**536,650**		554,457
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$**	**1,752,922**	$	1,764,018

The accompanying notes are an integral part of the consolidated financial statements**.**

Table of Contents

LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(In thousands, except share and per share data)

	Three months ended December 31,		Six months ended December 31,	
	2016	**2015**	**2016**	**2015**
Net sales	**$ 170,944**	$ 127,059	**$ 332,503**	$ 233,492
Cost of sales	**75,154**	51,800	**145,974**	80,619
Amortization of intangibles	**7,737**	3,614	**16,624**	3,801
Gross profit	**88,053**	71,645	**169,905**	149,072
Operating expenses:				
Research and development expenses	**9,939**	9,069	**22,310**	15,597
Selling, general and administrative expenses	**18,069**	14,666	**39,329**	30,202
Acquisition and integration-related expenses	**1,027**	17,585	**2,418**	21,527
Restructuring expenses	**1,712**		**3,764**	
Intangible asset impairment charges	**23,000**		**88,084**	
Total operating expenses	**53,747**	41,320	**155,905**	67,326
Operating income	**34,306**	30,325	**14,000**	81,746
Other income (loss):				
Investment income (loss)	**1,021**	975	**2,048**	(135)
Interest expense	**(23,333)**	(11,772)	**(46,327)**	(11,832)
Other	**(266)**	(30)	**(263)**	(30)
Total other loss	**(22,578)**	(10,827)	**(44,542)**	(11,997)
Income (loss) before income tax	**11,728**	19,498	**(30,542)**	69,749
Income tax expense (benefit)	**3,542**	5,958	**(9,340)**	23,013
Net income (loss)	**8,186**	13,540	**(21,202)**	46,736
Less: Net income attributable to noncontrolling interest	**14**	20	**34**	35
Net income (loss) attributable to Lannett Company, Inc.	**$ 8,172**	$ 13,520	**$ (21,236)**	$ 46,701
Earnings (loss) per common share attributable to Lannett Company, Inc.:				
Basic	**$ 0.22**	$ 0.37	**$ (0.58)**	$ 1.28
Diluted	**$ 0.22**	$ 0.36	**$ (0.58)**	$ 1.25
Weighted average common shares outstanding:				
Basic	**36,810,388**	36,388,542	**36,754,828**	36,349,597
Diluted	**37,676,370**	37,388,450	**36,754,828**	37,401,878

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(In thousands)

	Three months ended December 31,		Six months ended December 31,	
	2016	**2015**	**2016**	**2015**
Net income (loss)	**$ 8,186**	$ 13,540	**$ (21,202)**	$ 46,736
Other comprehensive income, before tax:				
Foreign currency translation gain	**41**	42	**38**	26
Total other comprehensive income, before tax	**41**	42	**38**	26
Income tax related to items of other comprehensive income				
Total other comprehensive income, net of tax	**41**	42	**38**	26
Comprehensive income (loss)	**8,227**	13,582	**(21,164)**	46,762
Less: Total comprehensive income attributable to noncontrolling interest	**14**	20	**34**	35
Comprehensive income (loss) attributable to Lannett Company Inc.	**$ 8,213**	$ 13,562	**$ (21,198)**	$ 46,727

The accompanying notes are an integral part of the consolidated financial statements**.**

Table of Contents

LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(UNAUDITED)

(In thousands)

	Stockholders Equity Attributable to Lannett Company Inc.								
	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholders Equity Attributable to Lannett Co., Inc.	Noncontrolling Interest	Total Stockholders Equity
	Shares Issued	Amount							
Balance, June 30, 2016	37,150	$ 37	$ 283,301	$ 278,355	$ (295)	$ (7,349)	$ 554,049	$ 408	$ 554,457
Shares issued in connection with share-based compensation plans	294		1,785				1,785		1,785
Share-based compensation			4,173				4,173		4,173
Excess tax benefits on share-based compensation awards			705				705		705
Purchase of noncontrolling interest			(1,058)				(1,058)	(442)	(1,500)
Purchase of treasury stock						(1,806)	(1,806)		(1,806)
Other comprehensive income, net of income tax					38		38		38
Net income (loss)				(21,236)			(21,236)	34	(21,202)
Balance, December 31, 2016	**37,444**	**$ 37**	**$ 288,906**	**$ 257,119**	**$ (257)**	**$ (9,155)**	**$ 536,650**	**$**	**$ 536,650**

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(In thousands)

	Six Months Ended December 31,	
	2016	**2015**
OPERATING ACTIVITIES:		
Net income (loss)	**$ (21,202)**	$ 46,736
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**27,963**	8,119
Deferred income tax expense (benefit)	**(24,709)**	1,743
Share-based compensation	**4,173**	6,398
Excess tax benefits on share-based compensation awards	**(705)**	(1,034)
Intangible assets impairment charges	**88,084**	
Loss on sale of assets	**267**	26
Loss (gain) on investment securities	**(1,697)**	334
Amortization of debt discount and other debt issuance costs	**10,509**	2,662
Other noncash expenses	**1,056**	
Changes in assets and liabilities which provided (used) cash, net of acquisition:		
Accounts receivable, net	**(17,219)**	5,306
Inventories	**(15,334)**	5,996
Prepaid income taxes/Income taxes payable	**1,827**	(13,652)
Other assets	**(7,099)**	(2,459)
Rebates payable	**14,891**	5,184
Royalties payable	**(1,577)**	2,684
Restructuring liability	**1,217**	
Settlement liability	**(3,000)**	
Accounts payable	**9,052**	(4,937)
Accrued expenses	**2,415**	5,636
Accrued payroll and payroll-related expenses	**(1,662)**	(7,117)
Net cash provided by operating activities	**67,250**	61,625
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	**(21,324)**	(10,629)
Proceeds from sale of property, plant and equipment	**33**	10
Acquisition, net of cash acquired		(929,581)
Proceeds from sale of investment securities	**31,019**	21,374
Purchase of investment securities	**(27,098)**	(22,227)
Net cash used in investing activities	**(17,370)**	(941,053)
FINANCING ACTIVITIES:		
Proceeds from issuance of debt		910,610
Repayments of long-term debt	**(26,618)**	(22,817)
Purchase of noncontrolling interest	**(1,500)**	
Proceeds from issuance of stock	**1,785**	2,689
Payment of debt issuance costs		(32,716)
Excess tax benefits on share-based compensation awards	**705**	1,034
Purchase of treasury stock	**(1,806)**	(908)

Net cash provided by (used in) financing activities		**(27,434)**		857,892
Effect on cash and cash equivalents of changes in foreign exchange rates		**38**		26
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**22,484**		(21,510)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		**224,769**		200,340
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$**	**247,253**	$	178,830
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Interest paid (net of amounts capitalized)	**$**	**34,986**	$	5,569
Income taxes paid	**$**	**13,553**	$	34,950

The accompanying notes are an integral part of the consolidated financial statements**.**

Table of Contents

LANNETT COMPANY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Interim Financial Information

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for the presentation of interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the unaudited financial statements do not include all the information and footnotes necessary for a comprehensive presentation of the financial position, results of operations and cash flows for the periods presented. In the opinion of management, the unaudited financial statements include all the normal recurring adjustments that are necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. Operating results for the three and six months ended December 31, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2017. These unaudited financial statements should be read in combination with the other Notes in this section; Management s Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 2; and the Consolidated Financial Statements, including the Notes to the Consolidated Financial Statements, included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2016. The Consolidated Financial Statements for the fiscal year ended June 30, 2016 were derived from audited financial statements.

Note 2. The Business And Nature of Operations

Lannett Company, Inc. (a Delaware corporation) and its subsidiaries (collectively, the Company or Lannett) develop, manufacture, package, market and distribute solid oral and extended release (tablets and capsules), topical, nasal and oral solution finished dosage forms of drugs, that address a wide range of therapeutic areas. Certain of these products are manufactured by others and distributed by the Company, most notably under the Jerome Stevens Distribution Agreement. The Company also manufactures active pharmaceutical ingredients through its Cody Laboratories, Inc. (Cody Labs) subsidiary, providing a vertical integration benefit.

On November 25, 2015, the Company completed the acquisition of Kremers Urban Pharmaceuticals, Inc. (KUPI), the former U.S. specialty generic pharmaceuticals subsidiary of global biopharmaceuticals company UCB S.A. KUPI is a specialty pharmaceuticals manufacturer focused on the development of products that are difficult to formulate or utilize specialized delivery technologies. Strategic benefits of the acquisition include expanded manufacturing capacity, a diversified product portfolio and pipeline and complementary research and development expertise.

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania; Cody, Wyoming; Carmel, New York and Seymour, Indiana. The Company s customers include generic pharmaceutical distributors, drug wholesalers, chain drug stores, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care organizations, hospital buying groups, governmental entities and health maintenance organizations.

Note 3. Summary of Significant Accounting Policies

Basis of Presentation

The Consolidated Financial Statements have been prepared in conformity with U.S. GAAP.

Principles of consolidation

The Consolidated Financial Statements include the accounts of Lannett Company, Inc. and its wholly owned subsidiaries, as well as Cody LCI Realty, LLC (Realty), a variable interest entity (VIE) in which the Company had a 50% ownership interest until November 30, 2016, when the Company acquired the remaining 50% interest. Noncontrolling interest in Realty was recorded net of tax as net income attributable to the noncontrolling interest. Additionally, all intercompany accounts and transactions have been eliminated.

Business Combinations

Acquired businesses are accounted for using the acquisition method of accounting, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective estimated fair values. The fair values and useful lives assigned to each class of assets acquired and liabilities assumed are based on, among other factors, the expected future period of benefit of the asset, the various characteristics of the asset and projected future cash flows. Significant judgment is employed in determining the assumptions utilized as of the acquisition date and for each subsequent measurement period. Accordingly, changes in assumptions described above, could have a material impact on our consolidated results of operations.

Table of Contents

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year financial statement presentation.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are required in the determination of revenue recognition and sales deductions for estimated chargebacks, rebates, returns and other adjustments including a provision for the Company s liability under the Medicare Part D program. Additionally, significant estimates and assumptions are required when determining the fair value of long-lived assets, including goodwill and intangible assets, income taxes, contingencies, share-based compensation and contingent consideration. Because of the inherent subjectivity and complexity involved in these estimates and assumptions, actual results could differ from those estimates.

Foreign currency translation

The Consolidated Financial Statements are presented in U.S. Dollars, the reporting currency of the Company. The financial statements of the Company s foreign subsidiary are maintained in local currency and translated into U.S. dollars at the end of each reporting period. Assets and liabilities are translated at period-end exchange rates, while revenues and expenses are translated at average exchange rates during the period. The adjustments resulting from the use of differing exchange rates are recorded as part of stockholders equity in accumulated other comprehensive income (loss). Gains and losses resulting from transactions denominated in foreign currencies are recognized in the Consolidated Statements of Operations under Other income (loss). Amounts recorded due to foreign currency fluctuations are immaterial to the Consolidated Financial Statements.

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities less than or equal to three months at the date of purchase to be cash and cash equivalents. Cash and cash equivalents are stated at cost, which approximates fair value, and consist of bank deposits and certificates of deposit that are readily convertible into cash. The Company maintains its cash deposits and cash equivalents at well-known, stable financial institutions. Such amounts frequently exceed insured limits.

Investment securities

The Company s investment securities consist of publicly-traded equity securities which are classified as trading investments. Investment securities are recorded at fair value based on quoted market prices from broker or dealer quotations or transparent pricing sources at each reporting date. Gains and losses are included in the Consolidated Statements of Operations under Other income (loss).

Allowance for doubtful accounts

The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses. The Company determines its allowance for doubtful accounts by considering a number of factors, including the length of time balances are past due, the Company s previous loss history, the customer s current ability to pay its obligations to the Company and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they are determined to be uncollectible.

Inventories

Inventories are stated at the lower of cost or market determined by the first-in, first-out method. Inventories are regularly reviewed and provisions for excess and obsolete inventory are recorded based primarily on current inventory levels and estimated sales forecasts.

Table of Contents

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the assets estimated useful lives. Depreciation expense for each of the three months ended December 31, 2016 and 2015 was $5.5 million and $2.4 million, respectively. Depreciation expense for each of the six months ended December 31, 2016 and 2015 was $10.6 million and $4.2 million, respectively.

Intangible Assets

Definite-lived intangible assets are stated at cost less accumulated amortization. Amortization of definite-lived intangible assets is computed on a straight-line basis over the assets estimated useful lives, generally for periods ranging from 10 to 15 years. The Company continually evaluates the reasonableness of the useful lives of these assets. Indefinite-lived intangible assets are not amortized, but instead are tested at least annually for impairment. Costs to renew or extend the term of a recognized intangible asset are expensed as incurred.

Valuation of Long-Lived Assets, including Intangible Assets

The Company s long-lived assets primarily consist of property, plant and equipment and definite and indefinite-lived intangible assets. Property, plant and equipment and definite-lived intangible assets are reviewed for impairment whenever events or changes in circumstances (triggering events) indicate that the carrying amount of the asset may not be recoverable. If a triggering event is determined to have occurred, the asset s carrying value is compared to the future undiscounted cash flows expected to be generated by the asset. If the carrying value exceeds the undiscounted cash flow of the asset, then impairment exists. Indefinite-lived intangible assets are tested for impairment at least annually during the fourth quarter of each fiscal year or more frequently if events or changes in circumstances indicate that the asset might be impaired. An impairment loss is measured as the excess of the asset s carrying value over its fair value, which in most cases is calculated using a discounted cash flow model. Discounted cash flow models are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates and the probability of achieving the estimated cash flows.

In-Process Research and Development

Amounts allocated to in-process research and development (IPR&D) in connection with a business combination are recorded at fair value and are considered indefinite-lived intangible assets subject to impairment testing in accordance with the Company s impairment testing policy for indefinite-lived intangible assets. As products in development are approved for sale, amounts will be allocated to product rights and will be amortized over their estimated useful lives. Definite-lived intangible assets are amortized over the expected life of the asset. The judgments made in determining the estimated fair value of in-process research and development, as well as asset lives, can materially impact our results of operations. The Company s fair value assessments are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates and the probability of achieving the estimated cash flows.

Goodwill

Goodwill, which represents the excess of purchase price over the fair value of net assets acquired, is carried at cost. Goodwill is tested for impairment on an annual basis on the first day of the fourth quarter of each fiscal year or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company first performs a qualitative assessment to determine if the quantitative impairment test is required. If changes in circumstances indicate an asset may be impaired, the Company performs the quantitative impairment test. In accordance with accounting standards, a two-step quantitative method is used for determining goodwill impairment. In the first step, the Company determines the fair value of our reporting unit (generic pharmaceuticals). If the net book value of our reporting unit exceeds its fair value, the second step of the impairment test which requires the hypothetical allocation of our reporting unit s fair value to all of its assets and liabilities using the acquisition method prescribed under authoritative guidance for business combinations would then be performed. Any residual fair value is allocated to goodwill. An impairment charge is recognized to the extent that the estimated fair value of our reporting unit s goodwill is less than its carrying amount. The judgments made in determining the estimated fair value of goodwill can materially impact our results of operations. The Company s fair value assessments are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates and the probability of achieving the estimated cash flows.

Table of Contents

Segment Information

The Company operates in one reportable segment, generic pharmaceuticals. As such, the Company aggregates its financial information for all products. The following table identifies the Company s net sales by medical indication for the three and six months ended December 31, 2016 and 2015:

(In thousands)	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
Medical Indication	**2016**	**2015**	**2016**	**2015**
Antibiotic	$ 4,792	$ 2,828	$ 8,572	$ 5,556
Anti Psychosis	15,365	730	32,685	3,472
Cardiovascular	11,975	13,082	24,669	21,385
Central Nervous System	10,555	6,077	20,904	6,077
Gallstone	13,425	18,719	26,308	38,691
Gastrointestinal	18,977	8,617	37,029	8,693
Glaucoma	5,311	6,543	11,095	13,365
Migraine	7,863	5,705	15,023	11,247
Muscle Relaxant	3,004	1,393	6,536	3,054
Obesity	960	851	1,795	1,830
Pain Management	7,439	8,074	14,047	16,207
Respiratory	2,957	1,396	5,170	1,396
Thyroid Deficiency	45,431	37,432	85,269	78,534
Urinary	4,693	3,378	9,794	3,593
Other	10,173	9,963	20,519	18,121
Contract manufacturing revenue	8,024	2,271	13,088	2,271
Total	$ 170,944	$ 127,059	$ 332,503	$ 233,492

Customer, Supplier and Product Concentration

The following table presents the percentage of total net sales, for the three and six months ended December 31, 2016 and 2015, for certain of the Company s products, defined as products containing the same active ingredient or combination of ingredients, which accounted for at least 10% of net sales in any of those periods:

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2016	**2015**	**2016**	**2015**
Product 1	27%	29%	26%	34%
Product 2	8%	15%	8%	17%

The following table presents the percentage of total net sales, for the three and six months ended December 31, 2016 and 2015, for certain of the Company s customers which accounted for at least 10% of net sales in any of those periods:

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2016	2015	2016	2015
Customer A	28%	27%	28%	27%
Customer B	20%	18%	20%	15%

The Company s primary finished goods inventory supplier is Jerome Stevens Pharmaceuticals, Inc. (JSP), in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for approximately 39% and 59% of the Company s inventory purchases during the three months ended December 31, 2016 and 2015, respectively. Purchases of finished goods inventory from JSP accounted for approximately 38% and 62% of the Company s inventory purchases during the six months ended December 31, 2016 and 2015, respectively. See Note 22 Material Contracts with Suppliers for more information.

Revenue Recognition

The Company recognizes revenue when title and risk of loss have transferred to the customer and provisions for rebates, promotional adjustments, price adjustments, returns, chargebacks and other potential adjustments are reasonably determinable. The Company also considers all other relevant criteria specified in Securities and Exchange Commission Staff Accounting Bulletin No. 104, Topic No. 13, *Revenue Recognition* , in determining when to recognize revenue.

Table of Contents

Net Sales Adjustments

When revenue is recognized a simultaneous adjustment to gross sales is made for chargebacks, rebates, returns, promotional adjustments and other potential adjustments. These provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable, depending on the nature of the reserve. The reserves, presented as a reduction of accounts receivable, totaled $179.3 million and $176.1 million at December 31, 2016 and June 30, 2016, respectively. Rebates payable at December 31, 2016 and June 30, 2016 were $36.8 million and $21.9 million, respectively, for certain rebate programs, primarily related to Medicare Part D, Medicaid and certain sales allowances and other adjustments paid to indirect customers.

Cost of Sales, including Amortization of Intangibles

Cost of sales includes all costs related to bringing products to their final selling destination, which includes direct and indirect costs, such as direct material, labor and overhead expenses. Additionally, cost of sales includes product royalties, depreciation, amortization and costs to renew or extend recognized intangible assets, freight charges and other shipping and handling expenses.

Research and Development

Research and development costs are expensed as incurred, including all production costs until a drug candidate is approved by the Food and Drug Administration (FDA). Research and development expenses include costs associated with internal projects as well as costs associated with third-party research and development contracts.

Contingencies

Loss contingencies, including litigation-related contingencies, are included in the Consolidated Statements of Operations when the Company concludes that a loss is both probable and reasonably estimable. Legal fees related to litigation-related matters are expensed as incurred and are included in the Consolidated Statements of Operations under the Selling, general and administrative line item.

Contingent Consideration

Contingent consideration resulting from the KUPI acquisition was recorded at its estimated fair value on the acquisition date. The Company has agreed to a 50/50 split of the additional tax liabilities UCB will incur associated with the IRS Section 338(H)(10) tax election, up to $35.0 million. This election is expected to result in additional tax benefits to the Company of approximately $100.0 million. These fair value measurements represent Level 3 measurements, as they are based on significant inputs not observable in the market.

Restructuring Costs

The Company records charges associated with approved restructuring plans to remove duplicative headcount and infrastructure associated with business acquisitions or to simplify business processes. Restructuring charges can include severance costs to eliminate a specified number of employees, infrastructure charges to vacate facilities and consolidate operations and contract cancellation costs. The Company records restructuring charges based on estimated employee terminations, site closure and consolidation plans. The Company accrues severance and other employee separation costs under these actions when it is probable that a liability exists and the amount is reasonably estimable.

Share-based Compensation

Share-based compensation costs are recognized over the vesting period, using a straight-line method, based on the fair value of the instrument on the date of grant less an estimate for expected forfeitures. The Company uses the Black-Scholes valuation model to determine the fair value of stock options and the stock price on the grant date to value restricted stock. The Black-Scholes valuation model includes various assumptions, including the expected volatility, the expected life of the award, dividend yield and the risk-free interest rate. These assumptions involve inherent uncertainties based on market conditions which are generally outside the Company s control. Changes in these assumptions could have a material impact on share-based compensation costs recognized in the financial statements.

Table of Contents

Income Taxes

The Company uses the liability method to account for income taxes as prescribed by Accounting Standards Codification (ASC) 740, *Income Taxes*. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. Deferred tax expense (benefit) is the result of changes in deferred tax assets and liabilities. Deferred income tax assets and liabilities are adjusted to recognize the effects of changes in tax laws or enacted tax rates in the period during which they are signed into law. The factors used to assess the likelihood of realization are the Company s forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Under ASC 740, *Income Taxes*, a valuation allowance is required when it is more likely than not that all or some portion of the deferred tax assets will not be realized through generating sufficient future taxable income. Failure to achieve forecasted taxable income in applicable tax jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company s effective tax rate on future earnings.

The Company may recognize the tax benefit from an uncertain tax position claimed on a tax return only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The authoritative accounting standards also provide guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures.

Earnings Per Common Share

Basic earnings per common share attributable to Lannett Company, Inc. is computed by dividing net income attributable to Lannett Company, Inc. common stockholders by the weighted average number of shares outstanding during the period. Diluted earnings per common share attributable to Lannett Company, Inc. is computed by dividing net income attributable to Lannett Company, Inc. common stockholders by the weighted average number of shares outstanding during the period including additional shares that would have been outstanding related to potentially dilutive securities. These potentially dilutive securities primarily consist of stock options, unvested restricted stock and an outstanding warrant. Anti-dilutive securities are excluded from the calculation. Dilutive shares are also excluded in the calculation in periods of net loss because the effect of including such securities would be anti-dilutive.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to the Company s stockholders. Other comprehensive income (loss) refers to gains and losses that are included in comprehensive income (loss), but excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The authoritative guidance is effective for annual reporting periods beginning after December 15, 2017. The Company is continuing to assess the impact this guidance will have on the consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Inventory Simplifying the Measurement of Inventory*. ASU 2015-11 requires inventory to be subsequently measured using the lower of cost and net realizable value, thereby eliminating the market value approach. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is applied prospectively. Early adoption is permitted. The Company does not believe this guidance will have a material impact on the consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations Simplifying the Accounting for Measurement-Period Adjustments*. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 also requires that the acquirer record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 is effective for reporting periods beginning after December 15, 2015 and is applied prospectively. Early adoption is permitted. The Company elected to early adopt ASU 2015-16 as of March 31, 2016.

Table of Contents

In November 2015, the FASB issued ASU 2015-17, *Income Taxes Balance Sheet Classification of Deferred Taxes.* ASU 2015-17 requires all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. The guidance may be applied either prospectively or retrospectively. ASU 2015-17 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company does not believe this guidance will have a material impact on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases.* ASU 2016-02 requires an entity to recognize right-of-use assets and liabilities on its balance sheet for all leases with terms longer than 12 months. Lessees and lessors are required to disclose quantitative and qualitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period and requires a modified retrospective application, with early adoption permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 clarifies several aspects of accounting for share-based compensation including the accounting for excess tax benefits and deficiencies, accounting for forfeitures and the classification of excess tax benefits on the cash flow statement. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016 and in interim periods within those fiscal years, with early adoption permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows Classification of Certain Cash Receipts and Cash Payments.* ASU 2016-15 addresses how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2017. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

Note 4. Acquisitions

Kremers Urban Pharmaceuticals Inc.

On November 25, 2015, the Company completed the acquisition of KUPI, the former U.S. specialty generic pharmaceuticals subsidiary of global biopharmaceuticals company UCB S.A., pursuant to the terms and conditions of a Stock Purchase Agreement. KUPI is a specialty pharmaceuticals manufacturer focused on the development of products that are difficult to formulate or utilize specialized delivery technologies. Strategic benefits of the acquisition include expanded manufacturing capacity, a diversified product portfolio and pipeline and complementary research and development expertise.

Pursuant to the terms of the Stock Purchase Agreement, Lannett purchased 100% of the outstanding equity interests of KUPI for total consideration of approximately $1.2 billion.

The following table summarizes the fair value of total consideration transferred to KUPI shareholders at the acquisition date of November 25, 2015:

(In thousands)		
Cash purchase price paid to KUPI shareholders	$	1,030,000
Working capital adjustment		(41,605)
Certain amounts reimbursable by UCB		(37,340)
Total cash consideration transferred to KUPI shareholders		951,055
12.0% Senior Notes issued to UCB		200,000
Acquisition-related contingent consideration		35,000
Warrant issued to UCB		29,920
Total consideration to KUPI shareholders	$	1,215,975

Table of Contents

The Company funded the acquisition and transaction expenses with proceeds from the issuance of the $910.0 million of term loans, $22.8 million borrowings from a revolving credit facility, the issuance of $250.0 million Senior Notes (see Note 12 Long-term Debt) and cash on hand of $94.6 million. Lannett also issued a warrant with an estimated fair value of $29.9 million.

As part of the acquisition, the Company and UCB have agreed to jointly make an election under Section 338(h)(10) of the Internal Revenue Code of 1986, as amended and under the corresponding provisions of state law, to treat the acquisition as a deemed purchase and sale of assets for income tax purposes. The Company has agreed to reimburse UCB for 50% of the incremental tax cost of making such election, subject to a reimbursement cap of $35.0 million. This liability has been recorded as acquisition-related contingent consideration on the Consolidated Balance Sheet. This election is expected to result in additional tax benefits to the Company of approximately $100.0 million.

The Company also agreed to contingent payments related to Methylphenidate Hydrochloride Extended Release tablets (Methylphenidate ER) provided the FDA reinstates the AB-rating for such product and certain sales thresholds are met. On October 18, 2016, the Company received notice from the FDA that it will seek to withdraw approval of the Company s ANDA for Methylphenidate ER. See Note 11 Goodwill and Intangible Assets for more information.

The Company used the acquisition method of accounting to account for this transaction. Under the acquisition method of accounting, the assets acquired and liabilities assumed in the transaction were recorded at the date of acquisition at their respective fair values.

The purchase price has been allocated to the assets acquired and liabilities assumed for the KUPI business as follows:

(In thousands)		Purchase Price Allocation
Cash and cash equivalents	$	16,877
Accounts receivable, net of revenue-related reserves		129,408
Inventories		84,009
Other current assets		11,238
Property, plant and equipment		111,849
Product rights		427,000
Trade name		2,920
Other intangible assets		19,000
In-process research and development		125,000
Goodwill		339,425
Deferred tax assets		4,186
Other assets		10,218
Total assets acquired		1,281,130
Accounts payable		(19,249)
Accrued expenses		(6,079)
Accrued payroll and payroll-related expenses		(21,040)
Rebates payable		(9,816)
Royalties payable		(3,602)
Other liabilities		(5,369)
Total net assets acquired	$	1,215,975

In the first quarter of Fiscal 2017, the Company recorded a $6.0 million measurement period adjustment to the Returns reserve.

Included in the purchase price allocation above are indemnification assets totaling approximately $20.7 million, of which $10.4 million relates to compensation-related payments, $4.9 million relates to unrecognized tax benefits and $5.4 million for chargeback and rebate-related items. The inventory balance above includes $19.1 million to reflect fair value step-up adjustments. KUPI s intangible assets primarily consist of product rights and in-process research and development. See Note 11 Goodwill and Intangible Assets.

Amounts allocated to acquired in-process research and development represent the fair value of purchased in-process technology for research projects that, as of the closing date of the acquisition, had not yet reached technological feasibility and had no alternative future use. The fair value of in-process research and development was based on the excess earnings method, which utilizes forecasts of expected cash inflows (including estimates for ongoing costs) and other contributory charges, on a project-by-project basis at the appropriate discount rate for the inherent risk in each project and will be tested for impairment in accordance with the Company s policy for testing indefinite-lived intangible assets.

Table of Contents

Goodwill of $339.4 million arising from the acquisition consists primarily of the value of the employee workforce and the value of products to be developed in the future. The goodwill was assigned to the Company s only reporting unit. Goodwill recognized is expected to be fully deductible for income tax purposes.

Unaudited Pro Forma financial results

The following supplemental unaudited pro forma information presents the financial results as if the acquisition of KUPI had occurred on July 1, 2014 for the three and six months ended December 31, 2015. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made on July 1, 2014, nor are they indicative of any future results.

(In thousands, except per share data)	**For the Three Months Ended December 31, 2015**	**For the Six Months Ended December 31, 2015**
Revenues	$ 173,189	$ 357,155
Net income attributable to Lannett Company, Inc.	28,810	55,129
Earnings per common share attributable to Lannett Company, Inc.:		
Basic	$ 0.79	$ 1.52
Diluted	$ 0.77	$ 1.47

The supplemental pro forma earnings for the three months ended December 31, 2015 were adjusted to exclude $23.3 million of acquisition-related costs, of which $17.6 million was incurred by Lannett and $5.7 million was incurred by KUPI, and to include $5.8 million of expense related to the amortization of fair value step-up adjustments to acquisition-date inventory.

The supplemental pro forma earnings for the six months ended December 31, 2015 were adjusted to exclude $28.9 million of acquisition-related costs, of which $21.5 million was incurred by Lannett and $7.4 million was incurred by KUPI, and to include $5.8 million of expense related to the amortization of fair value adjustments to acquisition-date inventory.

Note 5. Restructuring Charges

2016 Restructuring Program

On February 1, 2016, in connection with the acquisition of KUPI, the Company announced a plan related to the future integration of KUPI and the Company s operations. The plan focuses on the closure of KUPI s corporate functions and the consolidation of manufacturing, sales, research and development and distribution functions. The Company estimates that it will incur an aggregate of up to approximately $21.0 million in restructuring charges for actions that have been announced or communicated since the 2016 Restructuring Program began. Of this amount, approximately $12.0 million relates to employee separation costs, approximately $1.0 million relates to contract termination costs and approximately $8.0 million relates to facility closure costs and other actions. The 2016 Restructuring Program is expected to be completed by

the end of Fiscal 2019. The expenses associated with the restructuring program included in restructuring expenses during the three and six months ended December 31, 2016 were as follows:

(In thousands)	Three Months Ended December 31, 2016	Six Months Ended December 31, 2016
Employee separation costs	$ 1,004	$ 2,161
Facility closure costs	708	1,603
Total	$ 1,712	$ 3,764

A reconciliation of the changes in restructuring liabilities associated with the 2016 Restructuring Program from June 30, 2016 through December 31, 2016 is set forth in the following table:

(In thousands)	Employee Separation Costs	Contract Termination Costs	Facility Closure Costs	Total
Balance at June 30, 2016	$ 3,833	$ 297	$	$ 4,130
Restructuring Charges	2,161		1,603	3,764
Payments	(808)	(136)	(1,603)	(2,547)
Balance at December 31, 2016	$ 5,186	$ 161	$	$ 5,347

Table of Contents

Note 6. Accounts Receivable

Accounts receivable consisted of the following components at December 31, 2016 and June 30, 2016:

(In thousands)	December 31, 2016	June 30, 2016
Gross accounts receivable	$ 402,901	$ 388,460
Less Chargebacks reserve	(82,285)	(86,495)
Less Rebates reserve	(39,062)	(32,189)
Less Returns reserve	(44,608)	(40,593)
Less Other deductions	(13,329)	(16,851)
Less Allowance for doubtful accounts	(631)	(610)
Accounts receivable, net	$ 222,986	$ 211,722

For the three months ended December 31, 2016, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns and other deductions of $217.7 million, $73.5 million, $7.9 million, and $13.9 million, respectively. For the three months ended December 31, 2015, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns and other deductions of $151.0 million, $42.4 million, $7.1 million, and $8.9 million, respectively.

For the six months ended December 31, 2016, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of $416.2 million, $143.0 million, $14.7 million, and $29.3 million, respectively. For the six months ended December 31, 2015, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of $239.6 million, $70.2 million, $10.8 million, and $15.3 million, respectively.

Note 7. Inventories

Inventories at December 31, 2016 and June 30, 2016 consisted of the following:

(In thousands)	December 31, 2016	June 30, 2016
Raw materials	$ 52,270	$ 47,881
Work-in-process	18,600	20,207
Finished goods	59,368	46,816
Total	$ 130,238	$ 114,904

The reserve for excess and obsolete inventory was $6.1 million and $6.9 million at December 31, 2016 and June 30, 2016, respectively.

Note 8. Property, Plant and Equipment

Property, plant and equipment at December 31, 2016 and June 30, 2016 consisted of the following:

(In thousands)	Useful Lives	December 31, 2016	June 30, 2016
Land		$ 6,191	$ 6,191
Building and improvements	10 - 39 years	105,637	103,496
Machinery and equipment	5 - 10 years	134,239	120,272
Furniture and fixtures	5 - 7 years	2,673	2,904
Less accumulated depreciation		(64,049)	(53,598)
		184,691	179,265
Construction in progress		42,362	37,373
Property, plant and equipment, net		$ 227,053	$ 216,638

During the three and six months ended December 31, 2016 and 2015, the Company had no impairment charges related to property, plant and equipment. Property, plant and equipment, net included amounts held in foreign countries in the amount of $924 thousand and $1.0 million at December 31, 2016 and June 30, 2016, respectively.

Table of Contents

Note 9. Fair Value Measurements

The Company s financial instruments recorded in the Consolidated Balance Sheets include cash and cash equivalents, accounts receivable, investment securities, accounts payable, accrued expenses and debt obligations. Included in cash and cash equivalents are certificates of deposit with maturities less than or equal to three months at the date of purchase and money market funds. The carrying value of certain financial instruments, primarily cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, approximate their estimated fair values based upon the short-term nature of their maturity dates. The carrying amount of the Company s debt obligations approximates fair value based on current interest rates available to the Company on similar debt obligations.

The Company follows the authoritative guidance of ASC Topic 820 Fair Value Measurements and Disclosures. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The authoritative guidance also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company s financial assets and liabilities measured at fair value are entirely within Level 1 of the hierarchy as defined below:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.

Level 2 Directly or indirectly observable inputs, other than quoted prices, such as quoted prices for similar assets or liabilities; quoted prices for identical or similar instruments in markets that are not active; or model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Unobservable inputs that are supported by little or no market activity and that are material to the fair value of the asset or liability. Financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant judgment or estimation are examples of Level 3 assets and liabilities.

If the inputs used to measure the financial assets and liabilities fall within more than one level described above, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

The Company s recurring and nonrecurring assets and liabilities measured at fair value at December 31, 2016 and June 30, 2016, were as follows:

	December 31, 2016			
(In thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Equity securities	$ 11,870	$	$	$ 11,870

Intangible Assets - KUPI IPR&D (a)			18,000	18,000
Total Assets	$ 11,870	$	$ 18,000	$ 29,870
Liabilities				
Acquisition-related contingent consideration	$	$	$ 35,000	$ 35,000
Total Liabilities	$	$	$ 35,000	$ 35,000

	June 30, 2016			
(In thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Equity securities	$ 14,094	$	$	$ 14,094
Total Assets	$ 14,094	$	$	$ 14,094
Liabilities				
Acquisition-related contingent consideration	$	$	$ 35,000	$ 35,000
Total Liabilities	$	$	$ 35,000	$ 35,000

(a) Intangible assets related to KUPI s IPR&D with a carrying amount of $41.0 million were written down to a fair value of $18.0 million due to an impairment charge of $23.0 million recorded in the second quarter of Fiscal 2017.

Table of Contents

Note 10. Investment Securities

The Company uses the specific identification method to determine the cost of securities sold, which consisted entirely of securities classified as trading.

The Company had a net gain on investment securities of $888 thousand during the three months ended December 31, 2016, which primarily consisted of realized gains. The Company had a net gain on investment securities of $862 thousand during the three months ended December 31, 2015, which included an unrealized gain related to securities still held at December 31, 2015 of $838 thousand.

The Company had a net gain on investment securities of $1.7 million during the six months ended December 31, 2016, which included an unrealized gain related to securities still held at December 31, 2016 of $557 thousand. The Company had a net loss on investment securities of $334 thousand during the six months ended December 31, 2015, which included an unrealized loss related to securities still held at December 31, 2015 of $405 thousand.

Note 11. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill for the six months ended December 31, 2016 are as follows:

(In thousands)	Generic Pharmaceuticals
Balance at June 30, 2016	$ 333,611
Measurement-period adjustments	5,955
Balance at December 31, 2016	$ 339,566

In the first quarter of Fiscal 2017, the Company recorded a $6.0 million measurement-period adjustment to the Returns reserve.

Intangible assets, net as of December 31, 2016 and June 30, 2016, consisted of the following:

(In thousands)	Weighted Avg. Life (Yrs.)	Gross Carrying Amount		Accumulated Amortization		Intangible Assets, Net	
		December 31, 2016	June 30, 2016	December 31, 2016	June 30, 2016	December 31, 2016	June 30, 2016
Definite-lived:							
Cody Labs import license	15	$ 582	$ 582	$ (328)	$ (309)	$ 254	$ 273
KUPI product rights	15	434,000	427,000	(28,819)	(17,119)	405,181	409,881
KUPI trade name	2	2,920	2,920	(1,608)	(878)	1,312	2,042

KUPI other intangible assets	15	19,000	19,000	(1,395)	(762)	17,605	18,238
Silarx product rights	15	10,000	10,000	(1,056)	(722)	8,944	9,278
Other product rights	14	653	653	(333)	(311)	320	342
Total definite-lived		$ 467,155	$ 460,155	$ (33,539)	$ (20,101)	$ 433,616	$ 440,054
Indefinite-lived:							
KUPI in-process research and development		$ 18,000	$ 117,000	$	$	$ 18,000	$ 117,000
Silarx in-process research and development		18,000	18,000			18,000	18,000
Other product rights		449	449			449	449
Total indefinite-lived		36,449	135,449			36,449	135,449
Total intangible assets, net		$ 503,604	$ 595,604	$ (33,539)	$ (20,101)	$ 470,065	$ 575,503

For the three months ended December 31, 2016 and 2015, the Company recorded amortization expense of $8.1 million and $3.8 million, respectively. For the six months ended December 31, 2016 and 2015, the Company recorded amortization expense of $17.4 million and $3.9 million, respectively.

On October 18, 2016, the Company received a notice from the FDA indicating that the FDA will seek to withdraw approval of the Company s Methylphenidate ER ANDA. As a result of the notice, the Company performed an impairment analysis including a review of revised net sales projections for Methylphenidate ER. This analysis resulted in the Company recording a $65.1 million impairment charge in the first quarter of Fiscal 2017.

Table of Contents

In the second quarter of Fiscal 2017, the Company abandoned a project within KUPI s in-process research and development portfolio. The value assigned to the project was $23.0 million. Accordingly, the Company recorded a $23.0 million impairment charge in the second quarter.

Future annual amortization expense consisted of the following as of December 31, 2016:

(In thousands) Fiscal Year Ending June 30,	Annual Amortization Expense
2017	$ 16,204
2018	31,530
2019	30,946
2020	30,938
2021	30,938
Thereafter	293,060
	$ 433,616

Note 12. Long-Term Debt

Amended Senior Secured Credit Facility

On November 25, 2015, in connection with its acquisition of KUPI, Lannett entered into a credit and guaranty agreement (the Credit and Guaranty Agreement) among certain of its wholly-owned domestic subsidiaries, as guarantors, Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent and other lenders providing for a senior secured credit facility (the Senior Secured Credit Facility).

The Senior Secured Credit Facility consisted of a Term Loan A facility in an aggregate principal amount of $275.0 million, a Term Loan B facility in an aggregate principal amount of $635.0 million and a revolving credit facility providing for revolving loans in an aggregate principal amount of up to $125.0 million. On April 8, 2016, the Company drew down the full $125.0 million Revolving Credit Facility for working capital and other general purposes. The entire balance of the Revolving Credit Facility loan is outstanding as of December 31, 2016.

On June 17, 2016, Lannett amended the Senior Secured Credit Facility and the Credit and Guaranty Agreement to raise an incremental term loan in the principal amount of $150.0 million (the Incremental Term Loan) and amended certain sections of the agreement (the Amended Senior Secured Credit Facility). The terms of this Incremental Term Loan are substantially the same as those applicable to the Term Loan B facility. The Company used the proceeds of the Incremental Term Loan and cash on hand to repurchase the outstanding $250.0 million aggregate principal amount of Lannett s 12.0% Senior Notes due 2023 (the Senior Notes) issued in connection with the KUPI acquisition.

The Term Loan A Facility will mature on November 25, 2020. The Term Loan A Facility amortizes in quarterly installments (a) through December 31, 2017 in amounts equal to 1.25% of the original principal amount of the Term Loan A Facility and (b) from January 1, 2018 through September 30, 2020 in amounts equal to 2.50% of the original principal amount of the Term Loan A Facility, with the balance payable on November 25, 2020. The Term Loan B Facility will mature on November 25, 2022. The Term Loan B Facility amortizes in equal quarterly

installments in amounts equal to 1.25% of the original principal amount of the Term Loan B Facility with the balance payable on November 25, 2022. Any outstanding Revolving Loans will mature on November 25, 2020.

The Amended Senior Secured Credit Facility is guaranteed by all of Lannett s significant wholly-owned domestic subsidiaries (the Subsidiary Guarantors) and is collateralized by substantially all present and future assets of Lannett and the Subsidiary Guarantors.

The interest rates applicable to the Amended Term Loan Facility are based on a fluctuating rate of interest of the greater of an adjusted LIBOR and 1.00%, plus a borrowing margin of 4.75% (for Term Loan A Facility) or 5.375% (for Term Loan B Facility). The interest rate applicable to the Revolving Credit Facility is based on a fluctuating rate of interest of an adjusted LIBOR plus a borrowing margin of 4.75%. The interest rate applicable to the unused commitment for the Revolving Credit Facility was initially 0.50%. Beginning March 2016, the interest margins and unused commitment fee on the Revolving Credit Facility are subject to a leveraged based pricing grid.

Table of Contents

The Amended Senior Secured Credit Facility contains a number of covenants that, among other things, limit the ability of Lannett and its restricted subsidiaries to: incur more indebtedness; pay dividends; redeem stock or make other distributions of equity; make investments; create restrictions on the ability of Lannett s restricted subsidiaries that are not Subsidiary Guarantors to pay dividends to Lannett or make intercompany transfers; create negative pledges; create liens; transfer or sell assets; merge or consolidate; enter into sale leasebacks; enter into certain transactions with Lannett s affiliates; and prepay or amend the terms of certain indebtedness.

The Amended Senior Secured Credit Facility contains a financial performance covenant that is triggered when the aggregate principal amount of outstanding Revolving Credit Facility and outstanding letters of credit as of the last day of the most recent fiscal quarter is greater than 30% of the aggregate commitments under the Revolving Credit Facility. The covenant provides that Lannett shall not permit its first lien net senior secured leverage ratio as of the last day of any four consecutive fiscal quarters (i) from and after December 31, 2015, to be greater than 4.25:1.00 (ii) from and after December 31, 2017 to be greater than 3.75:1.00 and (iii) from and after December 31, 2019 to be greater than 3.25:1.00.

The Amended Senior Secured Credit Facility also contains a financial performance covenant for the benefit of the Term Loan A Facility lenders which provides that Lannett shall not permit its net senior secured leverage ratio as of the last day of any four consecutive fiscal quarters (i) prior to December 31, 2017, to be greater than 4.25:1.00, (ii) as of December 31, 2017 and prior to December 31, 2019 to be greater than 3.75:1.00 and (iii) as of December 31, 2019 and thereafter to be greater than 3.25:1.00.

The Amended Senior Secured Credit Facility also contains certain affirmative covenants, including financial and other reporting requirements.

In connection with the Senior Secured Credit Facility and the Senior Notes, the Company incurred an initial purchaser s discount of $72.1 million and debt issuance costs of $32.7 million. These costs are recorded as a reduction of long-term debt in the Consolidated Balance Sheet. In connection with the amendment to the Senior Secured Credit Facility and raising the Incremental Term Loan, the Company capitalized $14.0 million of initial purchaser s discount and other fees and expensed $2.2 million of legal and other expenses.

Long-term debt consisted of the following:

(In thousands)	December 31, 2016	June 30, 2016
Term Loan A due 2020	$ 261,250	$ 268,125
Unamortized discount and other debt issuance costs	(19,109)	(22,104)
Term Loan A, net	242,141	246,021
Term Loan B due 2022	747,554	767,226
Unamortized discount and other debt issuance costs	(70,039)	(77,273)
Term Loan B, net	677,515	689,953
Revolving Credit Facility due 2020	125,000	125,000
Other	804	874
Total debt, net	1,045,460	1,061,848
Less short-term borrowings and current portion of long-term debt	(178,239)	(178,236)
Total long-term debt, net	$ 867,221	$ 883,612

Debt amounts due, for the twelve month periods ending December 31 are as follows:

(In thousands)		Amounts Payable to Institutions
2017	$	178,239
2018		66,996
2019		67,003
2020		232,010
2021		39,518
Thereafter		550,842
Total	$	1,134,608

Table of Contents

Note 13. Legal, Regulatory Matters and Contingencies

Richard Asherman

On April 16, 2013, Richard Asherman (Asherman), the former President of and a member in Realty, filed a complaint (Complaint) in Wyoming state court against the Company and Cody Labs. At the same time, he also filed an application for a temporary restraining order to enjoin certain operations at Cody Labs, claiming, among other things, that Cody Labs was in violation of certain zoning laws and that Cody Labs was required to increase the level of its property insurance and to secure performance bonds for work being performed at Cody Labs. Mr. Asherman claimed Cody Labs was in breach of his employment agreement and was required to pay him severance under his employment agreement, including 18 months of base salary, vesting of unvested stock options and continuation of benefits. Mr. Asherman also asserted that the Company was in breach of the Realty Operating Agreement and, among other requested remedies, he sought to have the Company (i) pay him 50% of the value of 1.66 acres of land that Realty previously agreed to donate to an economic development entity associated with the City of Cody, Wyoming, which contemplated transaction has since been avoided and cancelled. Although Mr. Asherman originally sought to require that Lannett acquire his interest in Realty for an unspecified price and/or to dissolve Realty, those claims have been dismissed. In October 2016, the Company and Mr. Asherman reached a tentative agreement in principle to resolve their disputes. On November 30, 2016, the parties agreed to a settlement payment in full and final satisfaction of the claims filed by Asherman without an admission of liability by either party. As part of this settlement, the Company purchased the remaining noncontrolling interest in Realty, free and clear of all liens, claims and encumbrances.

Connecticut Attorney General Inquiry

In July 2014, the Company received interrogatories and subpoena from the State of Connecticut Office of the Attorney General concerning its investigation into pricing of digoxin. According to the subpoena, the Connecticut Attorney General is investigating whether anyone engaged in any activities that resulted in (a) fixing, maintaining or controlling prices of digoxin or (b) allocating and dividing customers or territories relating to the sale of digoxin in violation of Connecticut antitrust law. In June 2016, the Connecticut Attorney General issued interrogatories and a subpoena to an employee of the Company in order to gain access to documents and responses previously supplied to the Department of Justice. The Company maintains that it acted in compliance with all applicable laws and regulations and continues to cooperate with the Connecticut Attorney General s investigation.

Federal Investigation into the Generic Pharmaceutical Industry

In fiscal year 2015 and 2016, the Company and certain affiliated individuals each were served with a grand jury subpoena relating to a federal investigation of the generic pharmaceutical industry into possible violations of the Sherman Act. The subpoenas request corporate documents of the Company relating to corporate, financial and employee information, communications or correspondence with competitors regarding the sale of generic prescription medications and the marketing, sale, or pricing of certain products, generally for the period of 2005 through the dates of the subpoenas.

Based on reviews performed to date by outside counsel, the Company currently believes that it has acted in compliance with all applicable laws and regulations and continues to cooperate with the federal investigation.

Texas Medicaid Investigation

In August 2015, KUPI received a letter from the Texas Office of the Attorney General alleging that they had inaccurately reported certain price information in violation of the Texas Medicaid Fraud Prevention Act. UCB, KUPI s previous parent company is handling the defense and is evaluating the allegations and cooperating with the Texas Attorney General s Office. Per the terms of the Stock Purchase Agreement between the Company and UCB (Stock Purchase Agreement) dated September 2, 2015, the Company is fully indemnified for any pre-acquisition amounts. In conjunction with information received from UCB s legal counsel, the Company is currently unable to estimate the timing or the outcome of this matter.

Government Pricing

During the quarter ended December 31, 2016, the Company completed a contract compliance review, for the period January 1, 2012 through June 30, 2016, for one of KUPI s government-entity customers. As a result of the review, the Company identified certain commercial customer prices and other terms that were not properly disclosed to the government-entity resulting in potential overcharges. As of December 31, 2016, the Company s best estimate of the total liability for potential overcharges is approximately $9.3 million. For the period January 1, 2012 through November 24, 2015 (the pre-acquisition period), the Company is fully indemnified per the Stock Purchase Agreement. Accordingly, the Company has recorded an indemnification asset and related liability of $8.3 million related to the pre-acquisition period. The Company does not believe that the ultimate resolution of this matter will have a significant impact on our financial position, results of operations or cash flows.

Table of Contents

AWP Litigation

The Company and some of our competitors have been named as defendants in lawsuits filed in 2016 alleging that the Company and a number of other generic pharmaceutical manufacturers caused the Average Wholesale Prices (AWPs) of our and their products to be inflated, thereby injuring government programs, entities and persons who reimbursed prescription drugs based on AWPs. The Company stopped using AWP as a basis for establishing prices in or around 2002 and the bulk of prescription drugs manufactured by the Company was sold under private label. The Company disputes these allegations and does not believe that the ultimate resolution of these lawsuits will have a significant impact on our financial position, results of operations or cash flows.

Private Antitrust and Consumer Protection Litigation

The Company and certain competitors have been named as defendants in 22 lawsuits filed in 2016 alleging that the Company and certain generic pharmaceutical manufacturers have conspired to fix prices of generic digoxin and doxycycline. These cases have been consolidated in the United States District Court for the Eastern District of Pennsylvania. In January 2017, the Court granted the United States leave to intervene in the consolidated case.

In December 2016, four purported class action lawsuits were filed in the United States District Court for the Southern District of New York against the Company and other manufacturers and distributors of generic levothyroxine on behalf of direct and indirect purchasers. The cases generally allege that the Company and other manufacturers and distributors conspired to fix prices for generic levothyroxine products in violation of the federal Sherman Act, various state antitrust laws, and various state consumer protection statutes. In December 2016 and January 2017, three additional purported class action lawsuits in the United States District Court for the Eastern District of Pennsylvania against the Company and other manufacturers and distributors of generic levothyroxine on behalf of direct purchasers, asserting substantially similar claims for violation of the federal Sherman Act and claims for damages as the suits filed in the Southern District of New York.

On January 30, 2017, the Company and two other sellers of generic ursodiol were named as defendants in a purported class action lawsuit filed in the District of New Jersey on behalf of indirect purchasers of ursodiol. The case generally alleges that the Company and the other defendants conspired to fix prices for generic ursodiol products in violation of the federal Sherman Act, various state antitrust laws and various state consumer protection statutes.

The Company believes that it acted in compliance with all applicable laws and regulations. Accordingly, the Company disputes the allegations set forth in these class actions. The Company does not believe that the ultimate resolution of these lawsuits will have a significant impact on our financial position, results of operations or cash flows.

Shareholder Litigation

In November 2016, a suit was filed against the Company and two of its officers claiming that the Company in its securities filings made false and misleading statements in connection with its drug pricing methodologies and internal controls with respect to drug pricing methodologies

causing damage to the plaintiff. The complaint has not yet been served, but based upon the allegations as pleaded, the Company will be filing a motion to dismiss. The Company cannot reasonably predict the outcome of the suit at this time.

Patent Infringement (Paragraph IV Certification)

There is substantial litigation in the pharmaceutical industry with respect to the manufacture, use and sale of new products which are the subject of conflicting patent and intellectual property claims. Certain of these claims relate to paragraph IV certifications, which allege that an innovator patent is invalid or would not be infringed upon by the manufacture, use, or sale of the new drug.

Zomig®

The Company filed with the Food and Drug Administration an ANDA No. 206350, along with a paragraph IV certification, alleging that the two patents associated with the Zomig® nasal spray product (U.S. Patent No. 6,750,237 and U.S. Patent No. 67,220,767) are invalid.

In July 2014, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement lawsuits in the United States District Court for the District of Delaware, alleging that the Company s filing of ANDA No. 206350 constitutes an act of patent infringement and seeking a declaration that the two patents at issue are valid and infringed.

In September 2014, the Company filed a motion to dismiss one patent infringement lawsuit for lack of standing and responded to the second lawsuit by denying that any valid patent claim would be infringed. In the second lawsuit, the Company also counterclaimed for a declaratory judgment that the patent claims are invalid and not infringed. The Court has consolidated the two actions and denied the motion to dismiss the first action without prejudice.

Table of Contents

In July 2015, the Company filed with the United States Patent and Trademark Office (USPTO) a Petition for Inter Partes Review of each of the patents in suit seeking to reject as invalid all claims of the patents in suit. The USPTO has issued a decision denying initiation of the Inter Partes Review.

A trial was conducted in September 2016. Post-trial briefing has been completed and the court is expected to issue its decision in the next few months.

Thalomid®

The Company filed with the Food and Drug Administration an ANDA No. 206601, along with a paragraph IV certification, alleging that the fifteen patents associated with the Thalomid drug product (U.S. Patent Nos. 6,045,501; 6,315,720; 6,561,976; 6,561,977; 6,755,784; 6,869,399; 6,908,432; 7,141,018; 7,230,012; 7,435,745; 7,874,984; 7,959,566; 8,204,763; 8,315,886; 8,589,188 and 8,626,53) are invalid, unenforceable and/or not infringed. On January 30, 2015, Celgene Corporation and Children s Medical Center Corporation filed a patent infringement lawsuit in the United States District Court for the District of New Jersey, alleging that the Company s filing of ANDA No. 206601 constitutes an act of patent infringement and seeking a declaration that the patents at issue are valid and infringed. The Company filed an answer and affirmative defenses to the complaint.

A mediation before a magistrate judge was held on January 6, 2017 but a settlement was not reached. Discovery on the merits is underway.

Dilaudid®

The Company filed with the Food and Drug Administration an ANDA No. 207108, along with a paragraph IV certification, alleging that US Patent 6,589,960 associated with the Dilaudid® (hydromorphone oral solution) would not be infringed by the Company s proposed hydromorphone oral solution product and/or that the patent is invalid. On August 8, 2015, Purdue Pharmaceutical Products L.P, Purdue Pharma L.P and Purdue Pharma Technologies Inc. (Purdue) filed a patent infringement lawsuit in the United States District Court for the District of New Jersey, alleging that the Company s filing of ANDA No. 207108 constitutes an act of patent infringement and seeking a declaration that the patent at issue was infringed by the submission of ANDA No, 207108. The Company and Purdue have reached a settlement and the case was dismissed with prejudice in October 2016.

Although the Company cannot currently predict the length or outcome of paragraph IV litigation, legal expenses associated with these lawsuits could have a significant impact on the financial position, results of operations and cash flows of the Company.

Other Litigation Matters

The Company is also subject to various legal proceedings arising out of the normal course of its business including, but not limited to, product liability, intellectual property, patent infringement claims and antitrust matters. It is not possible to predict the outcome of these various proceedings. An adverse determination in any of these proceedings in the future could have a significant impact on the financial position, results of operations and cash flows of the Company.

Note 14. Commitments

Leases

The Company leases certain manufacturing and office equipment, in the ordinary course of business. These leases are typically renewed annually. Rental and lease expense was not material for all periods presented.

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) for the remainder of Fiscal 2017 and the twelve month periods ending June 30 thereafter are as follows:

(In thousands)		**Amounts Due**
Remainder of 2017	$	796
2018		1,142
2019		1,080
2020		1,080
2021		1,080
Thereafter		6,318
Total	$	11,496

Table of Contents

Note 15. Accumulated Other Comprehensive Loss

The Company s Accumulated Other Comprehensive Loss was comprised of the following components as of December 31, 2016 and 2015:

(In thousands)	December 31, 2016	December 31, 2015
Foreign Currency Translation		
Beginning Balance, June 30	$ (295)	$ (295)
Net gain (loss) on foreign currency translation (net of tax of $0 and $0)	38	26
Reclassifications to net income (net of tax of $0 and $0)		
Other comprehensive income (loss), net of tax	38	26
Ending Balance, December 31	(257)	(269)
Total Accumulated Other Comprehensive Loss	$ (257)	$ (269)

Note 16. Earnings (Loss) Per Common Share

A dual presentation of basic and diluted earnings per common share is required on the face of the Company s Consolidated Statement of Operations as well as a reconciliation of the computation of basic earnings per common share to diluted earnings per common share. Basic earnings per common share excludes the dilutive impact of potentially dilutive securities and is computed by dividing net income (loss) attributable to Lannett Company, Inc. by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is computed using the treasury stock method and includes the effect of potential dilution from the exercise of outstanding stock options and a warrant and treats unvested restricted stock as if it were vested. Potentially dilutive securities have been excluded in the weighted average number of common shares used for the calculation of earnings per share in periods of net loss because the effect of including such securities would be anti-dilutive. A reconciliation of the Company s basic and diluted earnings per common share was as follows:

(In thousands, except share and per share data)	Three Months Ended December 31, 2016	2015
Net income attributable to Lannett Company, Inc.	$ 8,172	$ 13,520
Basic weighted average common shares outstanding	36,810,388	36,388,542
Effect of potentially dilutive stock options, warrants and restricted stock awards	865,982	999,908
Diluted weighted average common shares outstanding	37,676,370	37,388,450
Earnings per common share attributable to Lannett Company, Inc.:		
Basic	$ 0.22	$ 0.37
Diluted	$ 0.22	$ 0.36

(In thousands, except share and per share data)	Six Months Ended December 31, 2016	2015
Net income (loss) attributable to Lannett Company, Inc.	$ (21,236)	$ 46,701

Basic weighted average common shares outstanding		36,754,828		36,349,597
Effect of potentially dilutive stock options, warrants and restricted stock awards				1,052,281
Diluted weighted average common shares outstanding		36,754,828		37,401,878
Earnings (loss) per common share attributable to Lannett Company, Inc.:				
Basic	$	(0.58)	$	1.28
Diluted	$	(0.58)	$	1.25

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the three months ended December 31, 2016 and 2015 were 3.0 million and 2.6 million, respectively. The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the six months ended December 31, 2016 and 2015 were 4.4 million and 2.6 million, respectively.

Table of Contents

Note 17. Warrant

In connection with the KUPI acquisition, Lannett issued to UCB Manufacturing a warrant to purchase up to a total of 2.5 million shares of Lannett s common stock (the Warrant).

The Warrant has a term of three years (expiring November 25, 2018) and an exercise price of $48.90 per share, subject to customary adjustments, including for stock splits, dividends and combinations. The Warrant also has a weighted average anti-dilution adjustment provision. The fair value included as part of the total consideration transferred to UCB at the acquisition date was $29.9 million. The fair value assigned to the Warrant was determined using the Black-Scholes valuation model. The Company concluded that the warrant was indexed to its own stock and therefore the Warrant has been classified as an equity instrument.

Note 18. Share-based Compensation

At December 31, 2016, the Company had two share-based employee compensation plans (the 2011 Long-Term Incentive Plan LTIP and the 2014 LTIP). Together these plans authorized an aggregate total of 4.5 million shares to be issued. The plans have a total of 2.1 million shares available for future issuances.

The Company issues share-based compensation awards with a vesting period ranging up to 3 years and a maximum contractual term of 10 years. The Company issues new shares of stock when stock options are exercised. As of December 31, 2016, there was $9.8 million of total unrecognized compensation cost related to non-vested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 2.0 years.

Stock Options

The Company measures share-based compensation cost for options using the Black-Scholes option pricing model. The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the six months ended December 31, 2016 and 2015, the estimated annual forfeiture rates used to recognize the associated compensation expense and the weighted average fair value of the options granted:

	Six Months Ended	
	December 31, 2016	December 31, 2015
Risk-free interest rate	1.1%	1.7%
Expected volatility	55.6%	48.3%
Expected dividend yield	0.0%	0.0%
Forfeiture rate	6.5%	6.5%
Expected term (in years)	5.2 years	5.2 years
Weighted average fair value	$ 15.33	$ 26.24

Expected volatility is based on the historical volatility of the price of our common shares during the historical period equal to the expected term of the option. The Company uses historical information to estimate the expected term, which represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period equal to the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The forfeiture rate assumption is the estimated annual rate at which unvested awards are expected to be forfeited during the vesting period. This assumption is based on our actual forfeiture rate on historical awards. Periodically, management will assess whether it is necessary to adjust the estimated rate to reflect changes in actual forfeitures or changes in expectations. Additionally, the expected dividend yield is equal to zero, as the Company has not historically issued and has no immediate plans to issue, a dividend.

Table of Contents

A stock option roll-forward as of December 31, 2016 and changes during the six months then ended, is presented below:

(In thousands, except for weighted average price and life data)	Awards	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Life (yrs.)
Outstanding at June 30, 2016	1,730	$ 16.77	$ 19,524	6.3
Granted	11	$ 31.30		
Exercised	(190)	$ 6.54	$ 4,325	
Forfeited, expired or repurchased	(19)	$ 31.40		
Outstanding at December 31, 2016	1,532	$ 17.96	$ 14,370	6.2
Vested and expected to vest at December 31, 2016	1,525	$ 17.85	$ 14,370	6.2
Exercisable at December 31, 2016	1,379	$ 15.64	$ 14,370	6.0

Restricted Stock

The Company measures restricted stock compensation costs based on the stock price at the grant date less an estimate for expected forfeitures. The annual forfeiture rate used to calculate compensation expense was 6.5% for the six months ended December 31, 2016 and 2015.

A summary of restricted stock awards as of December 31, 2016 and changes during the six months then ended, is presented below:

(In thousands)	Awards	Weighted Average Grant - date Fair Value	Aggregate Intrinsic Value
Non-vested at June 30, 2016	167	$ 48.22	
Granted	275	$ 25.03	
Vested	(76)	$ 43.80	$ 2,326
Forfeited	(18)	$ 37.13	
Non-vested at December 31, 2016	348	$ 31.38	

Employee Stock Purchase Plan

In February 2003, the Company s stockholders approved an Employee Stock Purchase Plan (ESPP). Employees eligible to participate in the ESPP may purchase shares of the Company s stock at 85% of the lower of the fair market value of the common stock on the first day of the calendar quarter, or the last day of the calendar quarter. Under the ESPP, employees can authorize the Company to withhold up to 10% of their compensation during any quarterly offering period, subject to certain limitations. The ESPP was implemented on April 1, 2003 and is qualified under Section 423 of the Internal Revenue Code. The Board of Directors authorized an aggregate total of 1.1 million shares of the Company s common stock for issuance under the ESPP. During the six months ended December 31, 2016 and 2015, 27 thousand shares and 11 thousand shares were issued under the ESPP, respectively. As of December 31, 2016, 512 thousand total cumulative shares have been issued under the

ESPP.

The following table presents the allocation of share-based compensation costs recognized in the Consolidated Statements of Operations by financial statement line item:

	Three Months Ended December 31,		Six Months Ended December 31,	
(In thousands)	**2016**	**2015**	**2016**	**2015**
Selling, general and administrative expenses	$ 1,251	$ 1,494	$ 3,223	$ 5,380
Research and development expenses	152	201	325	389
Cost of sales	314	329	625	629
Total	$ 1,717	$ 2,024	$ 4,173	$ 6,398
Tax benefit at statutory rate	$ 627	$ 729	$ 1,523	$ 2,303

Table of Contents

Note 19. Employee Benefit Plan

The Company has a 401k defined contribution plan (the Plan) covering substantially all employees. Pursuant to the Plan provisions, the Company is required to make matching contributions equal to 50% of each employee s contribution, not to exceed 4% of the employee s compensation for the Plan year. Contributions to the Plan during the three months ended December 31, 2016 and 2015 were $492 thousand and $188 thousand, respectively. Contributions to the Plan during the six months ended December 31, 2016 and 2015 were $1.1 million and $437 thousand, respectively.

Note 20. Income Taxes

The Company uses the liability method to account for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences reverse. Deferred tax expense (benefit) is the result of changes in deferred tax assets and liabilities.

The federal, state and local income tax expense for the three months ended December 31, 2016 and 2015 was $3.5 million and $6.0 million, respectively. The effective tax rates for the three months ended December 31, 2016 and 2015 were 30.2% and 30.6%, respectively. The federal, state and local income tax benefit for the six months ended December 31, 2016 was $9.3 million compared to income tax expense of $23.0 million for the six months ended December 31, 2015. The effective tax rates were 30.6% and 33.0%, respectively. The effective tax rate for the six months ended December 31, 2016 was lower compared to the six months ended December 31, 2015 primarily due to higher domestic manufacturing deductions and research and experimentation credits relative to expected annual pre-tax income, partially offset by the effect of changes in the Company s state tax profile as result of the KUPI acquisition.

The Company may recognize the tax benefit from an uncertain tax position claimed on a tax return only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

As of December 31, 2016 and June 30, 2016, the Company reported total unrecognized tax benefits of $6.6 million and $6.2 million, respectively, in other liabilities. As a result of the positions taken during the period, the Company has not recorded any interest and penalties for the period ended December 31, 2016 in the statement of operations and no cumulative interest and penalties have been recorded in the Company s statement of financial position as of December 31, 2016 and June 30, 2016. The Company will recognize interest accrued on unrecognized tax benefits in interest expense and any related penalties in operating expenses. The Company does not believe that the total unrecognized tax benefits will significantly increase or decrease in the next twelve months.

The Company files income tax returns in the United States federal jurisdiction and various states. The Company s tax returns for Fiscal Year 2012 and prior generally are no longer subject to review as such years generally are closed. The Company believes that an unfavorable resolution for open tax years would not be material to the financial position of the Company.

Note 21. Related Party Transactions

The Company had sales of $1.1 million and $529 thousand during the three months ended December 31, 2016 and 2015, respectively, to a generic distributor, Auburn Pharmaceutical Company (Auburn). Sales to Auburn for the six months ended December 31, 2016 and 2015 were $2.0 million and $866 thousand, respectively. Jeffrey Farber, Chairman of the Board, is the owner of Auburn. Accounts receivable includes amounts due from Auburn of $754 thousand and $682 thousand at December 31, 2016 and June 30, 2016, respectively.

Note 22. Material Contracts with Suppliers

Jerome Stevens Pharmaceuticals Distribution Agreement:

The Company s primary finished goods inventory supplier is JSP, in Bohemia, New York. Purchases of finished goods inventory from JSP accounted for approximately 39% and 59% of the Company s inventory purchases in the three months ended December 31, 2016 and 2015, respectively. Purchases of finished goods inventory from JSP accounted for 38% and 62% of the Company s inventory purchases in the six months ended December 31, 2016 and 2015, respectively.

Table of Contents

On August 19, 2013, the Company entered into an agreement with JSP to extend its initial contract to continue as the exclusive distributor in the United States of three JSP products: Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules USP; Digoxin Tablets USP; and Levothyroxine Sodium Tablets USP. The amendment to the original agreement extends the initial contract, which was due to expire on March 22, 2014, for five years through March 2019. In connection with the amendment, the Company issued a total of 1.5 million shares of the Company s common stock to JSP and JSP s designees. In accordance with its policy related to renewal and extension costs for recognized intangible assets, the Company recorded a $20.1 million expense in cost of sales, which represents the fair value of the shares on August 19, 2013. If the parties agree to a second five year extension from March 23, 2019 to March 23, 2024, the Company is required to issue to JSP or its designees an additional 1.5 million shares of the Company s common stock. Both Lannett and JSP have the right to terminate the contract if one of the parties does not cure a material breach of the contract within thirty (30) days of notice from the non-breaching party.

During the renewal term of the JSP Distribution Agreement, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP products. There is no guarantee that the Company will be able to meet the minimum purchase requirement for Fiscal 2017 and in the future. If the Company does not meet the minimum purchase requirements, JSP s sole remedy is to terminate the JSP Distribution Agreement.

Note 23. Subsequent Events

On January 23, 2017, the Company voluntarily made a $75.0 million payment against its outstanding revolving credit facility balance. As of January 31, 2017, the balance outstanding was $50.0 million.

Table of Contents

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

Cautionary Statement About Forward-Looking Statements

This Report on Form 10-Q and certain information incorporated herein by reference contains forward-looking statements which are not historical facts made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not promises or guarantees and investors are cautioned that all forward-looking statements involve risks and uncertainties, including but not limited to the impact of competitive products and pricing, product demand and market acceptance, new product development, acquisition-related challenges, the regulatory environment, interest rate fluctuations, reliance on key strategic alliances, availability of raw materials, fluctuations in operating results and other risks detailed from time to time in our filings with the Securities and Exchange Commission (the SEC). These statements are based on management s current expectations and are naturally subject to uncertainty and changes in circumstances. We caution you not to place undue reliance upon any such forward-looking statements which speak only as of the date made. Lannett is under no obligation to, and expressly disclaims any such obligation to, update or alter its forward-looking statements, whether as a result of new information, future events or otherwise.

The following information should be read in conjunction with the consolidated financial statements and notes in Part I, Item 1 of this Quarterly Report and with Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2016. All references to Fiscal 2017 or Fiscal Year 2017 shall mean the fiscal year ended June 30, 2017 and all references to Fiscal 2016 or Fiscal Year 2016 shall mean the fiscal year ended June 30, 2016.

Company Overview

Lannett Company, Inc. (a Delaware corporation) and its subsidiaries (collectively, the Company , Lannett , we or us) develop, manufacture, package, market and distribute solid oral and extended release (tablets and capsules), topical, nasal and oral solution finished dosage forms of drugs, that address a wide range of therapeutic areas. Certain of these products are manufactured by others and distributed by the Company. The Company also manufactures active pharmaceutical ingredients through its Cody Labs subsidiary, providing a vertical integration benefit. Additionally, the Company is pursuing partnerships, research contracts and internal expansion for the development and production of other dosage forms including: ophthalmic, nasal, patch, foam, buccal, sublingual, soft gel, injectable and oral dosages.

On November 25, 2015, the Company completed the acquisition of Kremers Urban Pharmaceutical, Inc. (KUPI), the former subsidiary of global biopharmaceuticals company UCB S.A. KUPI is a specialty pharmaceuticals manufacturer focused on the development of products that are difficult to formulate or utilize specialized delivery technologies. Strategic benefits of the acquisition include expanded manufacturing capacity, a diversified product portfolio and pipeline and complementary research and development expertise.

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania; Cody, Wyoming; Carmel, New York and Seymour, Indiana. The Company s customers include generic pharmaceutical distributors, drug wholesalers, chain drug stores, private label distributors, mail-order pharmacies, other pharmaceutical manufacturers, managed care organizations, hospital buying groups, governmental entities and health maintenance organizations.

2016 Restructuring Plan

On February 1, 2016, in connection with the acquisition of KUPI, the Company announced a plan related to the future integration of KUPI and the Company s operations (the 2016 Restructuring Program). The plan focuses on the closure of KUPI s corporate functions and the consolidation of manufacturing, sales, research and development and distribution functions. The Company estimates that it will incur an aggregate of up to approximately $21.0 million in restructuring charges for actions that have been announced or communicated since the 2016 Restructuring Program began. Of this amount, approximately $12.0 million relates to employee separation costs, approximately $1.0 million relates to contract termination costs and approximately $8.0 million relates to facility closures costs and other actions.

The plan is currently estimated to generate annualized synergies of approximately $50.0 million by the end of Fiscal 2018 and is expected to achieve an ultimate annual run rate of synergies totaling approximately $65.0 million by the end of Fiscal 2020.

These amounts are preliminary estimates based on the information currently available to management. It is possible that additional charges and future cash payments could occur in relation to the restructuring actions.

Table of Contents

Financial Summary

For the second quarter of Fiscal Year 2017, net sales increased to $170.9 million compared to $127.1 million in the same prior-year period. Gross profit increased to $88.1 million compared to $71.6 million in the prior-year period and gross profit percentage decreased to 52% compared to 56% in the prior-year period. R&D expenses increased 10% to $9.9 million compared to $9.1 million in the second quarter of Fiscal Year 2016 while SG&A expenses increased 23% to $18.1 million from $14.7 million. Acquisition and integration-related expenses decreased to $1.0 million from $17.6 million in the prior-year period. Restructuring expenses increased to $1.7 million as a result of implementing the 2016 Restructuring Program. Operating income for the second quarter of Fiscal Year 2017, which included a $23.0 million intangible asset impairment charge, was $34.3 million compared to $30.3 million in the second quarter of Fiscal Year 2016. Net income attributable to Lannett Company, Inc. for the second quarter of Fiscal Year 2017 was $8.2 million, or $0.22 per diluted share compared to $13.5 million or $0.36 per diluted share in the second quarter of Fiscal Year 2016.

For the first six months of Fiscal 2017, net sales increased to $332.5 million compared to $233.5 million in the same prior-year period. Gross profit increased $20.8 million to $169.9 million, compared to $149.1 million in the prior-year period. Gross profit percentage decreased to 51% compared to 64% in the prior-year period. R&D expenses increased 43% to $22.3 million compared to $15.6 million in the first six months of Fiscal 2016 while SG&A expenses increased 30% to $39.3 million from $30.2 million. Acquisition and integration-related expenses decreased to $2.4 million from $21.5 million in the prior-year period. Restructuring expenses increased to $3.8 million as a result of implementing the 2016 Restructuring Program. Operating income for the first six months of Fiscal 2017, which included an $88.1 million intangible assets impairment charge, was $14.0 million compared to $81.7 million in the prior-year period. Net loss attributable to Lannett Company, Inc. for the first six months of Fiscal 2017 was $21.2 million, or $0.58 per diluted share compared to net income attributable to Lannett Company, Inc. of $46.7 million or $1.25 per diluted share in the prior-year period.

A more detailed discussion of the Company s financial results can be found below.

Results of Operations - Three months ended December 31, 2016 compared with the three months ended December 31, 2015

Net sales increased 35% to $170.9 million for the three months ended December 31, 2016. The following table identifies the Company s net product sales by medical indication for the three months ended December 31, 2016 and 2015:

(In thousands)	Three Months Ended December 31,	
Medical Indication	**2016**	**2015**
Antibiotic	$ 4,792	$ 2,828
Anti Psychosis	15,365	730
Cardiovascular	11,975	13,082
Central Nervous System	10,555	6,077
Gallstone	13,425	18,719
Gastrointestinal	18,977	8,617
Glaucoma	5,311	6,543
Migraine	7,863	5,705
Muscle Relaxant	3,004	1,393
Obesity	960	851
Pain Management	7,439	8,074

Respiratory		2,957		1,396
Thyroid Deficiency		45,431		37,432
Urinary		4,693		3,378
Other		10,173		9,963
Contract manufacturing revenue		8,024		2,271
Total	$	170,944	$	127,059

The increase in net sales was primarily driven by additional sales of KUPI products of $38.1 million due to the timing of the acquisition as well as increased volumes of $5.0 million and increased product prices of $842 thousand. Although the Company has benefited in the past from favorable pricing trends, the trends are stabilizing and in, many instances, beginning to reverse. The level of competition in the marketplace is constantly changing and the Company cannot predict with certainty that these trends will continue.

Table of Contents

Beginning in January 2017, a provision in the Bipartisan Budget Act of 2015 will require drug manufacturers to pay additional rebates to State Medicaid programs if the prices of their generic drugs rise at a rate faster than inflation. Based on our forecasted product sales mix, we expect the new provision to lower our future Medicaid-related net sales.

The following chart details price and volume changes by medical indication:

Medical indication	Sales volume change %	Sales price change %	Acquisition change %
Antibiotic	64%	6%	%
Anti Psychosis	54%	1950%	%
Cardiovascular	(22)%	(32)%	45%
Central Nervous System	(26)%	(23)%	122%
Gallstone	(21)%	(8)%	%
Gastrointestinal	(8)%	(32)%	160%
Glaucoma	(5)%	(13)%	%
Migraine	52%	(14)%	%
Muscle Relaxant	349%	(233)%	%
Obesity	76%	(63)%	%
Pain Management	(4)%	(4)%	%
Respiratory	59%	(76)%	129%
Thyroid Deficiency	15%	6%	%
Urinary	(30)%	(42)%	111%

Anti Psychosis. Net sales of drugs used for the treatment of anti psychosis increased by $14.6 million. The increase in net sales was primarily attributable to product price increases on key products, and to a lesser extent, increased volumes.

Cardiovascular. Net sales of drugs used for cardiovascular treatment decreased by $1.1 million. The decrease was primarily the result of decreased volumes due to competition in the market for products used to treat congestive heart failure and price decreases on several key products. The decreases were partially offset by additional sales of KUPI products due to the timing of the acquisition.

Central Nervous System. Net sales of central nervous system products increased by $4.5 million. The increase was primarily attributable to additional sales of Methylphenidate Hydrochloride Extended Release tablets in the three months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. The increase was partially offset by decreased volumes and product price decreases. Sales of Methylphenidate Hydrochloride Extended Release tablets could continue to be affected by the changing regulatory environment as discussed below.

Methylphenidate Hydrochloride Extended Release Tablets (Methylphenidate ER)

During a teleconference in November 2014, the FDA informed KUPI that it had concerns about whether generic versions of Concerta (methylphenidate hydrochloride extended release tablets), including KUPI s Methylphenidate ER product, are therapeutically equivalent to Concerta. The FDA indicated that its concerns were based in part on adverse event reports concerning lack of effect and its analyses of pharmacokinetic data. The FDA informed KUPI that it was changing the therapeutic equivalence rating of its product from AB (therapeutically equivalent) to BX. A BX-rated drug is a product for which data are insufficient to determine therapeutic equivalence; it is still approved and can be prescribed, but the FDA does not recommend it as automatically substitutable for the brand-name drug at the pharmacy.

During the November 2014 teleconference, the FDA also asked KUPI to either voluntarily withdraw its product or to conduct new bioequivalence (BE) testing in accordance with the recommendations for demonstrating bioequivalence to Concerta proposed in a new draft BE guidance that the FDA issued earlier that November. The FDA had approved the KUPI product (and originally granted it an AB rating) in 2013, on the basis of KUPI data showing its product met BE criteria set forth in draft BE guidance that the FDA had issued in 2012. The FDA s position concerning the KUPI product was the subject of a public announcement by the agency. The Company agreed to conduct new BE studies per the new draft BE guidance. KUPI submitted the data from those studies to the FDA in June 2015. The Company continues to pursue the FDA to obtain its decision on the submitted study as well as its response on whether it will restore the AB-rating for our product.

On October 18, 2016, the Company received notice from the FDA that it will seek to withdraw approval of the Company s ANDA for Methylphenidate ER. The FDA s notice includes an opportunity for the Company to request a hearing on this matter. The Company initially had until November 17, 2016 to request the hearing and until December 19, 2016 to submit all data, information and analyses upon which the request for a hearing relies. As a result of the notice, the Company performed an impairment analysis including a review of revised net sales projections for Methylphenidate ER. This analysis resulted in the Company recording a $65.1 million impairment charge in the first quarter of Fiscal 2017.

Table of Contents

On November 30, 2016, the Company announced that the FDA granted a 90-day extension to submit documentation related to the hearing request. The new deadline for submitting the supporting documentation is March 20, 2017.

The Company intends to continue working to submit data to the FDA to regain the AB rating, or to maintain the drug on the U.S. market with a B-level rating, however, there can be no assurance as to when or if the Company will be permitted to remain on the market. If the Company were to receive the AB rating, net sales of the product could increase subject to market factors existing at that time. The Company also agreed to potential acquisition-related contingent payments to UCB related to Methylphenidate ER if the FDA reinstates the AB-rating and certain sales thresholds are met.

Gallstone. Net sales of drugs used for gallstones decreased by $5.3 million. The decrease in net sales was primarily attributable to decreased volumes as well as a decrease in the average selling price of key products.

Gastrointestinal. Net sales of gastrointestinal products increased by $10.4 million. The increase in net sales was primarily attributable to additional sales of KUPI products in the three months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. The increase was partially offset by product price decreases on certain key products and decreased volumes.

Glaucoma. Net sales of drugs used for the treatment of glaucoma decreased by $1.2 million. The decrease in net sales was primarily attributable to a decrease in the average selling price of key products as well as decreased volumes.

Pain Management. Net sales of pain management products decreased $635 thousand. The decrease in net sales was mainly attributable to decreases on the average selling price of key products and, to a lesser extent, decreased volumes.

Respiratory. Net sales of respiratory products increased by $1.6 million. The increase in net sales was primarily attributable to additional sales of KUPI products in the three months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. Excluding the impact of the additional sales of KUPI products in the current period, net sales of respiratory products decreased slightly as a result of product price decreases, partially offset by increased volumes.

Thyroid Deficiency. Net sales of drugs used for the treatment of thyroid deficiency increased by $8.0 million, primarily as a result of increased volumes and, to a lesser extent, increases in the average selling price of Levothyroxine.

Urinary. Net sales of urinary products increased by $1.3 million. The increase in net sales was primarily attributable to additional sales of KUPI products in the three months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. The increase was partially offset by product price decreases and decreased volumes due to increased competition.

Contract manufacturing revenue. Contract manufacturing revenue for the second quarter of Fiscal 2017 increased by $5.8 million, which was primarily attributable to the timing of the KUPI acquisition.

The Company sells its products to customers in various distribution channels. The table below presents the Company s net sales to each distribution channel for the three months ended December 31:

(In thousands) **Customer Distribution Channel**	**December 31, 2016**	**December 31, 2015**
Wholesaler/Distributor	$ 129,585	$ 92,704
Retail Chain	19,457	21,604
Mail-Order Pharmacy	13,878	10,480
Contract manufacturing revenue	8,024	2,271
Total	$ 170,944	$ 127,059

Net sales to wholesaler/distributor and mail-order pharmacies increased primarily as a result of additional net sales of KUPI products due to the timing of the KUPI acquisition. Net sales to retail chains decreased as a result of strategic partnerships within the industry, in which retailers submit orders through the wholesalers.

Table of Contents

Cost of Sales, including amortization of intangibles. Cost of sales, including amortization of intangibles, for the second quarter of Fiscal 2017 increased $27.5 million to $82.9 million. The increase was primarily attributable to additional cost of sales from KUPI due to the timing of the acquisition. Product royalties expense included in cost of sales totaled $5.1 million for the second quarter of Fiscal Year 2017 and $3.1 million for the second quarter of Fiscal Year 2016. Amortization expense included in cost of sales totaled $7.7 million for the second quarter of Fiscal Year 2017 and $3.6 million for the second quarter of Fiscal Year 2016. The increase primarily reflected additional amortization of the acquired intangibles from the acquisition of KUPI.

Gross Profit. Gross profit for the second quarter of Fiscal 2017 increased 23% to $88.1 million or 52% of net sales. In comparison, gross profit for the second quarter of Fiscal 2016 was $71.6 million or 56% of net sales. The decrease in gross profit percentage was attributable to the dilutive impact of KUPI products, additional amortization of intangibles, as well as depreciation of property, plant and equipment related to the acquisition of KUPI.

Research and Development Expenses. Research and development expenses for the second quarter increased 10% to $9.9 million in Fiscal 2017 from $9.1 million in Fiscal 2016. The increase was primarily due to the timing of the KUPI acquisition, which resulted in additional research and development expenses. The increase was partially offset by lower product development expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 23% to $18.1 million in the second quarter of Fiscal 2017 compared with $14.7 million in Fiscal 2016. The increase was primarily due to the timing of the KUPI acquisition, which resulted in additional selling, general and administrative expenses. Additional legal expenses also contributed to the increase.

The Company is focused on controlling operating expenses and has implemented its 2016 Restructuring Plan as noted above, however increases in personnel and other costs to facilitate enhancements in the Company s infrastructure and expansion may continue to impact operating expenses in future periods.

Acquisition and Integration-related Expenses. Acquisition and integration-related expenses decreased $16.6 million compared to the prior-year period. The decrease was due to higher costs during the second quarter of Fiscal 2016 associated with the acquisition of KUPI.

Restructuring Expenses. Restructuring expenses increased $1.7 million compared to the prior-year period as a result of implementing the 2016 Restructuring Program on February 1, 2016.

Intangible Asset Impairment Charge. In the second quarter of Fiscal 2017, the Company abandoned a project within KUPI s in-process research and development portfolio. The value assigned to the project was $23.0 million. Accordingly, the Company recorded a $23.0 million impairment charge in the second quarter.

Other Income (Loss). Interest expense for the three months ended December 31, 2016 totaled $23.3 million compared to $11.8 million for the three months ended December 31, 2015. Interest expense for the quarter ended December 31, 2015 included approximately one month of interest on the debt obligation used to finance the KUPI acquisition as compared to the three months ended December 31, 2016, which included a full quarter of interest expense. The weighted average interest rate for the second quarter of Fiscal 2017 was 8.0%. Investment income totaled $1.0 million in the second quarter of Fiscal 2017 compared with $975 thousand in the second quarter of Fiscal 2016.

Income Tax. The Company recorded income tax expense in the second quarter of Fiscal 2017 of $3.5 million compared to $6.0 million in the second quarter of Fiscal 2016. The effective tax rate for the three months ended December 31, 2016 was 30.2%, compared to 30.6% for the three months ended December 31, 2015.

Net Income. For the three months ended December 31, 2016, the Company reported net income attributable to Lannett Company, Inc. of $8.2 million, or $0.22 per diluted share. Comparatively, net income attributable to Lannett Company, Inc. in the corresponding prior-year period was $13.5 million, or $0.36 per diluted share.

Results of Operations - Six months ended December 31, 2016 compared with the six months ended December 31, 2015

Net sales increased 42% to $332.5 million for the six months ended December 31, 2016. The following table identifies the Company s net product sales by medical indication for the six months ended December 31, 2016 and 2015:

Table of Contents

(In thousands) Medical Indication	Six Months Ended December 31, 2016	2015
Antibiotic	$ 8,572	$ 5,556
Anti Psychosis	32,685	3,472
Cardiovascular	24,669	21,385
Central Nervous System	20,904	6,077
Gallstone	26,308	38,691
Gastrointestinal	37,029	8,693
Glaucoma	11,095	13,365
Migraine	15,023	11,247
Muscle Relaxant	6,536	3,054
Obesity	1,795	1,830
Pain Management	14,047	16,207
Respiratory	5,170	1,396
Thyroid Deficiency	85,269	78,534
Urinary	9,794	3,593
Other	20,519	18,121
Contract manufacturing revenue	13,088	2,271
Total	$ 332,503	$ 233,492

The increase in net sales was primarily driven by additional sales of KUPI products of $87.9 million due to the timing of the acquisition as well as increased volumes of $7.6 million and increased product prices of $3.5 million. Although the Company has benefited in the past from favorable pricing trends, the trends are stabilizing and in, many instances, beginning to reverse. The level of competition in the marketplace is constantly changing and the Company cannot predict with certainty that these trends will continue.

Beginning in January 2017, a provision in the Bipartisan Budget Act of 2015 will require drug manufacturers to pay additional rebates to State Medicaid programs if the prices of their generic drugs rise at a rate faster than inflation. Based on our forecasted product sales mix, we expect the new provision to lower our future Medicaid-related net sales.

The following chart details price and volume changes by medical indication:

Medical indication	Sales volume change %	Sales price change %	Acquisition change %
Antibiotic	53%	2%	%
Anti Psychosis	9%	832%	%
Cardiovascular	(20)%	(29)%	64%
Central Nervous System	(26)%	(23)%	292%
Gallstone	(21)%	(11)%	%
Gastrointestinal	(3)%	(35)%	365%
Glaucoma	(5)%	(12)%	%
Migraine	48%	(14)%	%
Muscle Relaxant	251%	(137)%	%
Obesity	30%	(32)%	%
Pain Management	(4)%	(9)%	%
Respiratory	59%	(76)%	288%
Thyroid Deficiency	10%	(1)%	%
Urinary	(27)%	(41)%	241%

Anti Psychosis. Net sales of drugs used for the treatment of anti psychosis increased by $29.2 million. The increase in net sales was primarily attributable to product price increases on key products, and to a lesser extent, increased volumes.

Cardiovascular. Net sales of drugs used for cardiovascular treatment increased by $3.3 million. The increase was primarily due to additional sales of KUPI products due to the timing of the acquisition. The increase was partially offset by decreased volumes due to competition in the market for products used to treat congestive heart failure and price decreases on several key products.

Central Nervous System. Net sales of central nervous system products increased by $14.8 million. The increase was primarily attributable to additional sales of Methylphenidate Hydrochloride Extended Release tablets in the six months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. The increase was partially offset by decreased volumes and product price decreases.

Table of Contents

Gallstone. Net sales of drugs used for gallstones decreased by $12.4 million. The decrease in net sales was primarily attributable to decreased volumes as well as a decrease in the average selling price of key products.

Gastrointestinal. Net sales of gastrointestinal products increased by $28.3 million. The increase in net sales was primarily attributable to additional sales of KUPI products in the six months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. The increase was partially offset by product price decreases and decreased volumes.

Glaucoma. Net sales of drugs used for the treatment of glaucoma decreased by $2.3 million. The decrease in net sales was primarily attributable to a decrease in the average selling price of key products as well as decreased volumes.

Pain Management. Net sales of pain management products decreased $2.2 million. The decrease in net sales was mainly attributable to decreases on the average selling price of key products and, to a lesser extent, decreased volumes.

Respiratory. Net sales of respiratory products increased by $3.8 million. The increase in net sales was primarily attributable to additional sales of KUPI products in the six months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. Excluding the impact of the additional sales of KUPI products in the current period, net sales of respiratory products decreased slightly as a result of product price decreases, partially offset by increased volumes.

Thyroid Deficiency. Net sales of drugs used for the treatment of thyroid deficiency increased by $6.7 million, primarily as a result of increased volumes, partially offset by a decrease in the average selling price of Levothyroxine.

Urinary. Net sales of urinary products increased by $6.2 million. The increase in net sales was primarily attributable to additional sales of KUPI products in the six months ended December 31, 2016 as compared to the same prior-year period due to the timing of the KUPI acquisition. The increase was partially offset by product price decreases and decreased volumes due to increased competition.

Contract manufacturing revenue. Contract manufacturing revenue for the first six months of Fiscal 2017 increased by $10.8 million, which was primarily attributable to the timing of the KUPI acquisition.

The Company sells its products to customers in various distribution channels. The table below presents the Company s net sales to each distribution channel for the six months ended December 31, 2016 and 2015:

(In thousands) Customer Distribution Channel	December 31, 2016	December 31, 2015
Wholesaler/Distributor	$ 254,510	$ 173,168
Retail Chain	39,551	39,138
Mail-Order Pharmacy	25,355	18,915
Contract manufacturing revenue	13,087	2,271
Total	$ 332,503	$ 233,492

Net sales to wholesaler/distributor, retail chains and mail-order pharmacies increased primarily as a result of additional net sales related to the KUPI acquisition.

Cost of Sales, including amortization of intangibles. Cost of sales, including amortization of intangibles for the first six months of Fiscal 2017 increased 93% to $162.6 million from $84.4 million in the same prior-year period. The increase was primarily attributable to additional cost of sales from KUPI due to the timing of the acquisition. Product royalties expense included in cost of sales totaled $9.9 million for the first six months of Fiscal Year 2017 and $4.3 million for the first six months of Fiscal Year 2016. Amortization expense included in cost of sales totaled $16.6 million for the first six months of Fiscal Year 2017 and $3.8 million for the first six months of Fiscal Year 2016. The increase primarily reflected additional amortization of the acquired intangibles from the acquisition of KUPI.

Gross Profit. Gross profit for the first six months of Fiscal 2017 increased 14% to $169.9 million or 51% of net sales. In comparison, gross profit for the first six months of Fiscal 2016 was $149.1 million or 64% of net sales. The decrease in gross profit percentage was attributable to dilutive impact of KUPI products, additional amortization of intangibles, as well as amortization of inventory step-up and depreciation of property, plant and equipment related to the acquisition of KUPI.

Table of Contents

Research and Development Expenses. Research and development expenses for the first six months increased 43% to $22.3 million in Fiscal 2017 from $15.6 million in Fiscal 2016. The increase was primarily due to the timing of the KUPI acquisition, which resulted

in additional research and development expenses. Increased spending related to C-Topical clinical trials also contributed to the increase.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 30% to $39.3 million in the first six months of Fiscal 2017 compared with $30.2 million in Fiscal 2016. The increase was primarily due to the timing of the KUPI acquisition, which resulted in additional selling, general and administrative expenses. Increased headcount as well as additional legal and consulting costs also contributed to the increase.

The Company is focused on controlling operating expenses and has implemented its 2016 Restructuring Plan as noted above, however increases in personnel and other costs to facilitate enhancements in the Company s infrastructure and expansion may continue to impact operating expenses in future periods.

Acquisition and Integration-related Expenses. Acquisition and integration-related expenses decreased $19.1 million compared to the prior-year period. The decrease was due to higher costs during the first six months of Fiscal 2016 associated with the acquisition of KUPI.

Restructuring Expenses. Restructuring expenses increased $3.8 million compared to the prior-year period as a result of implementing the 2016 Restructuring Program on February 1, 2016.

Intangible Asset Impairment Charges. On October 18, 2016, the Company received notice from the FDA that it will seek to withdraw approval of the Company s ANDA for Methylphenidate ER. As a result of the notice, the Company performed an impairment analysis including a review of revised net sales projections for Methylphenidate ER. This analysis resulted in the Company recording a $65.1 million impairment charge in the first quarter of Fiscal 2017. Additionally, in the second quarter of Fiscal 2017, the Company abandoned a project within KUPI s in-process research and development portfolio. The value assigned to the project was $23.0 million. Accordingly, the Company recorded a $23.0 million impairment charge in the second quarter.

Other Income (Loss). Interest expense in the first six months of Fiscal 2017 totaled $46.3 million compared to $11.8 million in Fiscal 2016. Interest expense during the six months ended December 31, 2015 included approximately one month of interest on the debt obligation used to finance the KUPI acquisition as compared to the six months ended December 31, 2016, which included six months of interest expense. The weighted average interest rate for the first six months of Fiscal 2017 was 7.9%. Investment income in the first six months of Fiscal 2017 totaled $2.0 million compared to investment losses of $135 thousand in Fiscal 2016.

Income Tax. The Company recorded an income tax benefit in the first six months of Fiscal 2017 of $9.3 million compared to income tax expense of $23.0 million in the first six months of Fiscal 2016. The effective tax rate for the six months ended December 31, 2016 was 30.6% compared to 33.0% for the six months ended December 31, 2015. The effective tax rate for the six months ended December 31, 2016 was lower compared to the six months ended December 31, 2015 primarily due to higher domestic manufacturing deductions and research and experimentation credits relative to expected annual pre-tax income, partially offset by the effect of changes in the Company s state tax profile as result of the KUPI acquisition.

Net Income (Loss). For the six months ended December 31, 2016, the Company reported net loss attributable to Lannett Company, Inc. of $21.2 million, or $0.58 per diluted share. Comparatively, net income attributable to Lannett Company, Inc. in the corresponding prior-year period was $46.7 million, or $1.25 per diluted share.

Liquidity and Capital Resources

Cash Flow

Until November 25, 2015, the date of the KUPI acquisition, the Company had historically financed its operations with cash flow generated from operations supplemented with borrowings from various government agencies and financial institutions. At December 31, 2016, working capital was $332.9 million as compared to $306.1 million at June 30, 2016, an increase of $26.8 million. Current product portfolio sales as well as sales related to future product approvals are anticipated to continue to generate positive cash flow from operations, which we expect will be sufficient to service our outstanding debt.

Net cash provided by operating activities of $67.3 million for the six months ended December 31, 2016 reflected net loss of $21.2 million, adjustments for non-cash items of $104.9 million, as well as cash used by changes in operating assets and liabilities of $16.4 million. In comparison, net cash provided by operating activities of $61.6 million for the six months ended December 31, 2015 reflected net income of $46.7 million, adjustments for non-cash items of $18.3 million, as well as cash used by changes in operating assets and liabilities of $3.4 million.

Table of Contents

Significant changes in operating assets and liabilities from June 30, 2016 to December 31, 2016 were comprised of:

- An increase in accounts receivable of $17.2 million mainly due to the timing of collections during the quarter ended December 31, 2016 compared to the quarter ended June 30, 2016. The Company s days sales outstanding (DSO) at December 31, 2016, based on gross sales for the six months ended December 31, 2016 and gross accounts receivable at December 31, 2016 was 75 days. The level of DSO at December 31, 2016 was comparable to the Company s expectations that DSO will be in the 70 to 80 day range based on customer payment terms.

- An increase in inventories totaling $15.3 million primarily due to a decision to increase our inventory supply of certain key products in order to meet customer demands.

- An increase in rebates payable of $14.9 million due to an increase in rebate-eligible sales to government programs as well as the timing of processed rebates

- An increase in accounts payable totaling $9.1 million due to the timing of vendor payments.

Significant changes in operating assets and liabilities from June 30, 2015 to December 31, 2015 were comprised of:

- A decrease in accounts receivable of $5.3 million mainly due to the timing of collections during the quarter ended December 31, 2015 compared to the quarter ended June 30, 2015. The Company s days sales outstanding (DSO) at December 31, 2015, based on gross sales for the three months ended December 31, 2015 and gross accounts receivable at December 31, 2015, was 72 days. The level of DSO at December 31, 2014 was comparable to the Company s expectation that DSO will be in the 70 to 80 day range based on customer payment terms.

- An increase in rebates payable of $5.2 million due to an increase in rebate eligible sales to wholesalers as well an increase in Medicaid rebates.

- A decrease in accounts payable totaling $4.9 million due to the timing of payments.

- An increase in prepaid income taxes totaling $13.7 million. The amount was mainly due to estimated tax payments, partially offset by current tax liabilities associated with pre-tax income for the six months ended December 31, 2015.

- A decrease in accrued payroll and payroll related costs of $7.1 million primarily related to payments made in August 2015 in connection with incentive compensation accrued in Fiscal Year 2015.

Net cash used in investing activities of $17.4 million for the six months ended December 31, 2016 is mainly the result of purchases of investment securities of $27.1 million and purchases of property, plant and equipment of $21.3 million, partially offset by proceeds from the sale of investment securities of $31.0 million. Net cash used in investing activities of $941.0 million for the six months ended December 31, 2015 is mainly the result of the acquisition of KUPI totaling $929.6 million (net of cash acquired), purchases of investment securities of $22.2 million

and purchases of property, plant and equipment of $10.6 million, partially offset by proceeds from the sale of investment securities of $21.4 million.

Net cash used in financing activities of $27.4 million for the six months ended December 31, 2016 was primarily due to debt repayments of $26.6 million, purchases of treasury stock totaling $1.8 million and purchase of the noncontrolling interest in Realty of $1.5 million, partially offset by proceeds from issuance of stock pursuant to stock compensation plans of $1.8 million and excess tax benefits on share-based compensation awards of $705 thousand. Net cash provided by financing activities of $857.9 million for the six months ended December 31, 2015 was primarily due to proceeds from the issuance of debt totaling $910.6 million, proceeds from issuance of stock pursuant to stock compensation plans of $2.7 million and excess tax benefits on stock option exercises of $1.0 million, partially offset by payments of debt issuance costs totaling $32.7 million, debt repayments of $22.8 million and purchases of treasury stock totaling $908 thousand.

Credit Facility and Other Indebtedness

The Company has previously entered into and may enter future agreements with various government agencies and financial institutions to provide additional cash to help finance the Company s various capital investments and potential strategic opportunities. These borrowing arrangements as of December 31, 2016 are as follows:

Table of Contents

Amended Senior Secured Credit Facility

On November 25, 2015, in connection with its acquisition of KUPI, Lannett entered into a credit and guaranty agreement (the Credit and Guaranty Agreement) among certain of its wholly-owned domestic subsidiaries, as guarantors, Morgan Stanley Senior Funding, Inc., as administrative agent and collateral agent and other lenders providing for a senior secured credit facility (the Senior Secured Credit Facility). The Senior Secured Credit Facility consisted of Term Loan A in an aggregate principal amount of $275.0 million, Term Loan B in an aggregate principal amount of $635.0 million and a revolving credit facility providing for revolving loans in an aggregate principal amount of up to $125.0 million. On April 8, 2016, the Company drew down the full $125.0 million Revolving Credit Facility for working capital and other general purposes. The entire balance of the Revolving Credit Facility loan is outstanding as of December 31, 2016.

On June 17, 2016, Lannett amended the Senior Secured Credit Facility and the Credit and Guaranty Agreement to raise an incremental term loan in the principal amount of $150.0 million (the Incremental Term Loan) and amended certain sections of the agreement (the Amended Senior Secured Credit Facility). The terms of this Incremental Term Loan are substantially the same as those applicable to the Term Loan B. The Company used the proceeds of the Incremental Term Loan and cash on hand to repurchase the outstanding $250.0 million aggregate principal amount of Lannett s 12.0% Senior Notes due 2023 (the Senior Notes) issued in connection with the KUPI acquisition.

The Term Loan A Facility will mature on November 25, 2020. The Term Loan A Facility amortizes in quarterly installments (a) through December 31, 2017 in amounts equal to 1.25% of the original principal amount of the Term Loan A Facility and (b) from January 1, 2018 through September 30, 2020 in amounts equal to 2.50% of the original principal amount of the Term Loan A Facility, with the balance payable on November 25, 2020. The Term Loan B Facility will mature on November 25, 2022. The Term Loan B Facility amortizes in equal quarterly installments in amounts equal to 1.25% of the original principal amount of the Term Loan B Facility with the balance payable on November 25, 2022. Any outstanding Revolving Loans will mature on November 25, 2020.

The Amended Senior Secured Credit Facility is guaranteed by all of Lannett s significant wholly-owned domestic subsidiaries (the Subsidiary Guarantors) and is collateralized by substantially all present and future assets of Lannett and the Subsidiary Guarantors. The interest rates applicable to the Amended Term Loan Facility are based on a fluctuating rate of interest of the greater of an adjusted LIBOR and 1.00%, plus a borrowing margin of 4.75% (for Term Loan A Facility) or 5.375% (for Term Loan B Facility). The interest rates applicable to the Revolving Credit Facility is based on a fluctuating rate of interest of an adjusted LIBOR plus a borrowing margin of 4.75%. The interest rate applicable to the unused commitment for the Revolving Credit Facility was initially 0.50%. Beginning March 2016, the interest margins and unused commitment fee on the Revolving Credit Facility are subject to a leveraged based pricing grid.

The Amended Senior Secured Credit Facility contains a number of covenants that, among other things, limit the ability of Lannett and its restricted subsidiaries to: incur more indebtedness; pay dividends; redeem stock or make other distributions of equity; make investments; create restrictions on the ability of Lannett s restricted subsidiaries that are not Subsidiary Guarantors to pay dividends to Lannett or make intercompany transfers; create negative pledges; create liens; transfer or sell assets; merge or consolidate; enter into sale leasebacks; enter into certain transactions with Lannett s affiliates; and prepay or amend the terms of certain indebtedness.

The Amended Senior Secured Credit Facility contains a financial performance covenant that is triggered when the aggregate principal amount of outstanding Revolving Credit Facility and outstanding letters of credit as of the last day of the most recent fiscal quarter is greater than 30% of the aggregate commitments under the Revolving Credit Facility. The covenant provides that Lannett shall not permit its first lien net senior secured leverage ratio as of the last day of any four consecutive fiscal quarters (i) from and after December 31, 2015, to be greater than 4.25:1.00 (ii) from and after December 31, 2017 to be greater than 3.75:1.00 and (iii) from and after December 31, 2019 to be greater than 3.25:1.00.

The Amended Senior Secured Credit Facility also contains a financial performance covenant for the benefit of the Term Loan A Facility lenders which provides that Lannett shall not permit its net senior secured leverage ratio as of the last day of any four consecutive fiscal quarters (i) prior to December 31, 2017, to be greater than 4.25:1.00, (ii) as of December 31, 2017 and prior to December 31, 2019 to be greater than 3.75:1.00 and (iii) as of December 31, 2019 and thereafter to be greater than 3.25:1.00.

The Amended Senior Secured Credit Facility also contains certain affirmative covenants, including financial and other reporting requirements.

Table of Contents

Cody Mortgage

Realty owns land and a building which is being leased to Cody Labs. A mortgage loan with First National Bank of Cody has been consolidated in the Company s financial statements, along with the related land and building. As of December 31, 2016 and June 30, 2016, the effective rate was 4.5% per annum. The mortgage is collateralized by the land and building with a net book value of $1.4 million. As of December 31, 2016, $804 thousand is outstanding under the mortgage loan, of which $144 thousand is classified as currently due.

Other Liquidity Matters

Material Suppliers

During the renewal term of the JSP Distribution Agreement, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP products. There is no guarantee that the Company will continue to meet the minimum purchase requirement for Fiscal 2017 and thereafter. If the Company does not meet the minimum purchase requirements, JSP s sole remedy is to terminate the agreement.

Cody Expansion

On January 26, 2017, the Company announced that it will launch a $50.0 million expansion of its Cody Labs facilities.

Future Acquisitions

We are continuously evaluating the potential for product and company acquisitions as a part of our future growth strategy. In conjunction with a potential acquisition, the Company may utilize current resources or seek additional sources of capital to finance any such acquisition, which could have an impact on future liquidity.

We may also from time to time depending on market conditions and prices, contractual restrictions, our financial liquidity and other factors, seek to prepay outstanding debt or repurchase our outstanding debt through open market purchases, privately negotiated purchases, or otherwise. The amounts involved in any such transactions, individually or in the aggregate, may be material and may be funded from available cash or from additional borrowings.

Research and Development Arrangements

In the normal course of business, the Company has entered into certain research and development and other arrangements. As part of these arrangements, the Company has agreed to certain contingent payments which generally become due and payable only upon the achievement of certain developmental, regulatory, commercial and/or other milestones. In addition, under certain arrangements, we may be required to make royalty payments based on a percentage of future sales, or other metric, for products currently in development in the event that the Company begins to market and sell the product. Due to the inherent uncertainty related to these developmental, regulatory, commercial and/or other milestones, it is unclear if the Company will ever be required to make such payments.

Prospects for the Future

Over the last several years, we have grown to be a formidable generic drug company. We have earned the respect of our customers by our continuous growth in product offerings and our extraordinary service as a reliable supplier. The Company s strong regulatory record and the ability to respond to our customers needs make our Company a desirable supplier. In 2016, we once again won the prestigious Diana Award for Best Generic Manufacturer from the Healthcare Distribution Alliance.

Over the past several years, Lannett continued to experience substantial improvement in many important financial metrics. Each year, our knowledge, staffs skills and talent increase. The Company is strengthening and building momentum to grow within the generic pharmaceutical industry organically and through mergers and acquisitions. The recently completed acquisitions of Silarx and KUPI demonstrates our ability to grow through M&A.

One initiative at the core of the Company s long term strategy is our plan to vertically integrate our supply chain. Acquired in 2007 we continue leveraging Cody Labs. In July 2008, the DEA granted Cody Labs a license to directly import concentrated poppy straw for extraction into opioid-based active pharmaceutical ingredients (APIs) such as Morphine Base, Hydromorphone, Hydrocodone and Oxycodone, for use in various dosage forms for pain management. The value of this license comes from the successful development of patentable processes. Cody Labs has filed and received numerous patents using their expertise in API development and manufacture. Our technical skills allow the Company to perform in a market with high barriers to entry and limited foreign and domestic competition.

Table of Contents

Because of this vertical integration, the Company has direct control of those APIs manufactured by Cody. In this fashion we can avoid increased costs, add to the Company s overall margins and avoid supply chain interruptions associated with buying APIs from third-party manufacturers. The Company can also leverage this vertical integration not only for direct supply of opioid-based APIs, but also for the manufacture of non-opioid-based controlled drugs such as Cocaine HCl.

The Company believes that demand for controlled substances and pain management drugs, having grown from $3 billion in 2005 to over $31 billion today, will continue based upon the Baby Boomer demographics. By concentrating additional resources in the development of opioid-based APIs and dosage forms, the Company is well-positioned to take advantage of this opportunity. The Company is currently vertically integrated on three products, with several others in various stages of development.

One product that the Company manufactures is a brand drug for use in surgery. Our C-Topical® Solution brand of cocaine hydrochloride involves the successful patented synthetic process developed by Cody. This product is being manufactured and marketed under the product name C-Topical® Solution. This product is an analgesic topical solution, with vasoconstriction as a side effect, for use primarily by ear, nose and throat physicians during surgical procedures. This product represents the Company s first foray into the brand market. Currently, we have completed the Phase III study and our CRO is assembling the data for our New Drug Application. As the Company continues to invest in and focus on process and manufacturing optimization, Cody Labs will continue to be an important part of our future growth plan.

Selling brand versus generic products require a dedicated sales force to detail and educate physicians on the product. The Company strongly believes that C-Topical®, once FDA has granted approval, will be an important contributor to total revenue, with higher than average profit margins as a result of vertical integration. The Company s strategic goal is to continue investing in controlled substance product development. Revenues from manufactured products derived from controlled substances carry higher-than-average gross margins.

In addition to focusing on the development and manufacture of opioid-based APIs and dosage forms, the Company has made a decision to develop products which require a paragraph four (P-IV) certification when filing the ANDA. A P-IV certification is required when an ANDA is submitted for a product for which the innovator s patent has not yet expired. The certification must state whether the patent on the reference listed drug (RLD) is being challenged on grounds of it being invalid, or if the patent is being circumvented. This path to product approval represents an opportunity for our Company, because we do not have to wait until a particular patent expires to potentially enter the market. Secondly, if our Company is the first-to-file a P-IV certification on a product and we successfully invalidate or circumvent the patent, the FDA may grant 180 days of market exclusivity. This allows us to be the sole competitor to the brand currently on the market for six months unless the innovator company sells an authorized generic. During this market exclusivity period, we could capture a significant portion of the market from the brand company at reasonably higher prices than our older products.

The Company filed its first ANDA with a P-IV certification in Fiscal 2013. As of December 31, 2016, we have 11 P-IV certifications pending with the FDA. Two of the P-IV certifications are currently being challenged. In response to our P-IV certification with respect to the Zomig® nasal spray product, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement complaints against the Company in July 2014. In response to our P-IV certification with respect to Thalomid®, Celgene Corporation and Children s Medical Center Corporation filed a patent infringement lawsuit against the Company in January 2015. Refer to Note 13 Legal, Regulatory Matters and Contingencies for additional information.

The Company has a business development group focused on mergers, acquisitions and other strategic alliances. The Company is party to supply and development agreements with JSP, Summit Bioscience LLC, HEC Pharm Group, Pharma Pass II LLC and various other international and domestic companies. The Company is currently in negotiations of similar agreements with other companies and is actively seeking additional

strategic partnerships, through which it will market and distribute products manufactured in-house or by third parties. The Company plans to continue evaluating potential merger and acquisition opportunities as well as product acquisitions that are a strategic fit and accretive to the business.

After we closed upon the KUPI acquisition, we established a very aggressive integration plan. We are pleased to say that our integration plans are moving swiftly and we will be benefitting from the synergies created through integration.

Table of Contents

We are pleased to announce that the FDA inspected our overseas pharmacokinetic subsidiary Darmantest Laboratory as well as Firmplace, a joint venture stability lab this fall. Both Darmantest and Firmplace passed inspection. These operations may affect lower cost benefits for stability and bioequivalency studies in the future.

Critical Accounting Policies

The preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States and the rules and regulations of the U.S. Securities & Exchange Commission requires the use of estimates and assumptions. A listing of the Company s significant accounting policies are detailed in Note 3 Summary of Significant Accounting Policies. A subsection of these accounting policies have been identified by management as Critical Accounting Policies. Critical accounting policies are those which require management to make estimates using assumptions that were uncertain at the time the estimates were made and for which the use of different assumptions, which reasonably could have been used, could have a material impact on the financial condition or results of operations.

Management has identified the following as Critical Accounting Policies : Revenue Recognition, Inventories, Income Taxes, Valuation of Long-Lived Assets, including Goodwill and Intangible Assets, In-Process Research and Development and Share-based Compensation.

Revenue Recognition

The Company recognizes revenue when title and risk of loss have transferred to the customer and provisions for estimates, including rebates, promotional adjustments, price adjustments, returns, chargebacks and other potential adjustments are reasonably determinable. The Company also considers all other relevant criteria specified in Securities and Exchange Commission Staff Accounting Bulletin No. 104, Topic No. 13, Revenue Recognition, in determining when to recognize revenue.

When revenue is recognized, a simultaneous adjustment to gross sales is made for chargebacks, rebates, returns, promotional adjustments and other potential adjustments. These provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable. The reserves presented as a reduction of accounts receivable totaled $179.3 million and $176.1 million at December 31, 2016 and June 30, 2016, respectively. Rebates payable at December 31, 2016 and June 30, 2016 were $36.8 million and $21.9 million, respectively, for certain rebate programs, primarily related to Medicare Part D, Medicaid and certain sales allowances and other adjustments paid to indirect customers.

The following table identifies the activity and ending balances of each major category of revenue reserve for the six months ended December 31, 2016 and 2015:

	Chargebacks	Rebates	Returns	Other	Total

Reserve Category (In thousands)					
Balance at June 30, 2016	$ 86,495	$ 54,084	$ 40,593	$ 16,851	$ 198,023
Additions related to an acquisition		8,329	5,955		14,284
Current period provision	416,212	143,016	14,728	29,307	603,263
Credits issued during the period	(420,422)	(129,583)	(16,668)	(32,829)	(599,502)
Balance at December 31, 2016	$ 82,285	$ 75,846	$ 44,608	$ 13,329	$ 216,068

Reserve Category (In thousands)	Chargebacks	Rebates	Returns	Other	Total
Balance at June 30, 2015	$ 35,801	$ 20,498	$ 19,209	$ 1,528	$ 77,036
Additions related to an acquisition	44,366	34,474	15,691	7,386	101,917
Current period provision	239,637	70,179	10,844	15,257	335,917
Credits issued during the period	(233,846)	(66,500)	(7,572)	(14,606)	(322,524)
Balance at December 31, 2015	$ 85,958	$ 58,651	$ 38,172	$ 9,565	$ 192,346

For the three months ending December 31, 2016 and 2015, as a percentage of gross sales the provision for chargebacks was 45.7% and 45.2%, the provision for rebates was 15.5% and 12.7%, the provision for returns was 1.7% and 2.1%, and the provision for other adjustments was 2.9% and 2.7%, respectively.

Table of Contents

For the six months ending December 31, 2016 and 2015, as a percentage of gross sales the provision for chargebacks was 45.1% and 42.3%, the provision for rebates was 15.5% and 12.4%, the provision for returns was 1.6% and 1.9%, and the provision for other adjustments was 3.2% and 2.7%, respectively.

The increase in total reserves from June 30, 2016 to December 31, 2016 was mainly due to an increase in rebates reserve for potential liabilities for overcharges to a government entity as well as additional sales incentives. The activity in the Other category for the six months ended December 31, 2016 and 2015 includes shelf-stock, shipping and other sales adjustments including prompt payment discounts. In the first quarter of Fiscal 2017, the Company recorded a $6.0 million measurement-period adjustment to the Returns reserve acquired in the KUPI acquisition. In the second quarter of Fiscal 2017, the Company recorded a $8.3 million adjustment to the Rebates reserve for potential overcharges to a government entity related to the KUPI acquisition. The amount is fully indemnified per the Stock Purchase Agreement as discussed in Note 13. Legal, Regulatory Matters and Contingencies. Historically, we have not recorded any material amounts in the current period related to reversals or additions of prior period reserves. If the Company were to record a material reversal or addition of any prior period reserve amount it would be separately disclosed.

Provisions for chargebacks, rebates, returns and other adjustments require varying degrees of subjectivity. While rebates generally are based on contractual terms and require minimal estimation, chargebacks and returns require management to make more subjective assumptions. Each major category is discussed in detail below:

Chargebacks

The provision for chargebacks is the most significant and complex estimate used in the recognition of revenue. The Company sells its products directly to wholesale distributors, generic distributors, retail pharmacy chains and mail-order pharmacies. The Company also sells its products indirectly to independent pharmacies, managed care organizations, hospitals, nursing homes and group purchasing organizations, collectively referred to as indirect customers. The Company enters into agreements with its indirect customers to establish pricing for certain products. The indirect customers then independently select a wholesaler from which to purchase the products. If the price paid by the indirect customers is lower than the price paid by the wholesaler, the Company will provide a credit, called a chargeback, to the wholesaler for the difference between the contractual price with the indirect customers and the wholesaler purchase price. The provision for chargebacks is based on expected sell-through levels by the Company s wholesale customers to the indirect customers and estimated wholesaler inventory levels. As sales to the large wholesale customers, such as Cardinal Health, AmerisourceBergen and McKesson increase (decrease), the reserve for chargebacks will also generally increase (decrease). However, the size of the increase (decrease) depends on product mix and the amount of sales made to indirect customers with which the Company has specific chargeback agreements. The Company continually monitors the reserve for chargebacks and makes adjustments when management believes that expected chargebacks may differ from the actual chargeback reserve.

Rebates

Rebates are offered to the Company s key chain drug store, distributor and wholesaler customers to promote customer loyalty and increase product sales. These rebate programs provide customers with credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers. Additionally, as a result of the Patient Protection and Affordable Care Act (PPACA) enacted in the U.S. in March 2010, the Company participates in a new cost-sharing

program for certain Medicare Part D beneficiaries designed primarily for the sale of brand drugs and certain generic drugs if their FDA approval was granted under a New Drug Application (NDA) or 505(b) NDA versus an ANDA. Because our drugs used for the treatment of thyroid deficiency and our Morphine Sulfate Oral Solution product were both approved by the FDA as 505(b)(2) NDAs, they are considered brand drugs for purposes of the PPACA. Drugs purchased within the Medicare Part D coverage gap (commonly referred to as the donut hole) result in additional rebates. The Company estimates the reserve for rebates and other promotional credit programs based on the specific terms in each agreement when revenue is recognized. The reserve for rebates increases (decreases) as sales to certain wholesale and retail customers increase (decrease). However, since these rebate programs are not identical for all customers, the size of the reserve will depend on the mix of sales to customers that are eligible to receive rebates.

Returns

Consistent with industry practice, the Company has a product returns policy that allows customers to return product within a specified time period prior to and subsequent to the product s expiration date in exchange for a credit to be applied to future purchases. The Company s policy requires that the customer obtain pre-approval from the Company for any qualifying return. The Company estimates its provision for returns based on historical experience, changes to business practices, credit terms and any extenuating circumstances known to management. While historical experience has allowed for reasonable estimations in the past, future returns may or may not follow historical trends. The Company continually monitors the reserve for returns and makes adjustments when management believes that actual product returns may differ from the established reserve. Generally, the reserve for returns increases as net sales increase.

Table of Contents

Other Adjustments

Other adjustments consist primarily of price adjustments, also known as shelf-stock adjustments and price protections, which are both credits issued to reflect increases or decreases in the invoice or contract prices of the Company s products. In the case of a price decrease, a credit is given for product remaining in customer s inventories at the time of the price reduction. Contractual price protection results in a similar credit when the invoice or contract prices of the Company s products increase, effectively allowing customers to purchase products at previous prices for a specified period of time. Amounts recorded for estimated shelf-stock adjustments and price protections are based upon specified terms with direct customers, estimated changes in market prices and estimates of inventory held by customers. The Company regularly monitors these and other factors and evaluates the reserve as additional information becomes available. Other adjustments also include prompt payment discounts.

Inventories

Inventories are stated at the lower of cost or market determined by the first-in, first-out method. Inventories are regularly reviewed and provisions for excess and obsolete inventory are recorded based primarily on current inventory levels and estimated sales forecasts. During the three months ended December 31, 2016 and 2015, the Company recorded provisions for excess and obsolete inventory of $2.1 million and $1.6 million, respectively. During the six months ended December 31, 2016 and 2015, the Company recorded provisions for excess and obsolete inventory of $5.4 million and $2.8 million, respectively.

Income Taxes

The Company uses an asset and liability approach to account for income taxes as prescribed by ASC 740, Income Taxes. Deferred taxes are recorded to reflect the tax consequences on future years of events that the Company has already recognized in the financial statement or tax returns. Deferred income tax assets and liabilities are adjusted to recognize the effect of changes in tax law or tax rates in the period during which the new law is enacted. Under ASC 740, Income Taxes, a valuation allowance is required when it is more likely than not that all or some portion of the deferred tax assets will not be realized through generating sufficient future taxable income. Failure to achieve forecasted taxable income in applicable tax jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company s effective tax rate on future earnings.

The Company may recognize the tax benefit from an uncertain tax position claimed on a tax return only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The benefit from uncertain tax positions recorded in the financial statements was immaterial for all period presented.

The Company s future effective income tax rate is highly reliant on future projections of taxable income, tax legislation, and potential tax planning strategies. A change in any of these factors could materially affect the effective income tax rate of the Company in future periods.

Business Combinations

Acquired businesses are accounted for using the acquisition method of accounting, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective estimated fair values. The fair values and useful lives assigned to each class of assets acquired and liabilities assumed are based on, among other factors, the expected future period of benefit of the asset, the various characteristics of the asset and projected future cash flows. Significant judgment is employed in determining the assumptions utilized as of the acquisition date and for each subsequent measurement period. Accordingly, changes in assumptions described above, could have a material impact on our consolidated results of operations.

Valuation of Long-Lived Assets, including Goodwill and Intangible Assets

The Company s long-lived assets primarily consist of property, plant and equipment, definite and indefinite-lived intangible assets and goodwill .

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the assets estimated useful lives, generally for periods ranging from 5 to 39 years. Definite-lived intangible assets are stated at cost less accumulated amortization and are amortized on a straight-line basis over the assets estimated useful lives, generally for periods ranging from 10 to 15 years. The Company continually evaluates the reasonableness of the useful lives of these assets.

Table of Contents

Property, plant and equipment and definite-lived intangible assets are reviewed for impairment whenever events or changes in circumstances (triggering events) indicate that the carrying amount of the asset may not be recoverable. The nature and timing of triggering events by their very nature are unpredictable; however, management regularly considers the performance of an asset as compared to its expectations, industry events, industry and economic trends, as well as any other relevant information known to management when determining if a triggering event occurred. If a triggering event is determined to have occurred, the first step in the impairment test is to compare the asset s carrying value to the undiscounted cash flows expected to be generated by the asset. If the carrying value exceeds the undiscounted cash flow of the asset, then an impairment exists. An impairment loss is measured as the excess of the asset s carrying value over its fair value, which in most cases is calculated using a discounted cash flow model. Discounted cash flow models are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates and the probability of achieving the estimated cash flows. The judgments made in determining the estimated fair value can materially impact our results of operations. There can be no assurances as to when, or if, future impairments may occur.

Goodwill and indefinite-lived intangible assets, including in-process research and development, are not amortized. Instead, goodwill and indefinite-lived intangible assets are tested for impairment annually during the fourth quarter of each fiscal year, or more frequently whenever events or changes in circumstances (triggering events) indicate that the asset might be impaired. The Company first performs a qualitative assessment to determine if the quantitative impairment test is required. If changes in circumstances indicate an asset may be impaired, the Company performs the quantitative test. The quantitative impairment test consists of a Step I analysis that requires a comparison between the reporting unit s fair value and carrying amount. If the fair value of the reporting unit exceeds its carrying amount, impairment does not exist and no further analysis is required. A Step II analysis would be required if the fair value of the reporting unit is lower than its carrying amount. If the carrying amount of a reporting unit exceeds the fair value, Step II of the quantitative impairment test requires the allocation of the reporting unit fair value to all of its assets and liabilities using the acquisition method prescribed under authoritative guidance for business combinations with any residual fair value being allocated to goodwill or indefinite-lived intangibles. An impairment charge is recognized only when the implied fair value of the reporting unit s goodwill or indefinite-lived intangible is less than its carrying amount. The Company s fair value assessments are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates and the probability of achieving the estimated cash flows. The judgments made in determining the estimated fair value of goodwill and indefinite-lived intangible asset can materially impact our results of operations. There can be no assurances as to when, or if, future impairments may occur. The Company has one reportable segment and one reporting unit, generic pharmaceuticals.

In-Process Research and Development

Acquired businesses are accounted for using the acquisition method of accounting. The acquisition purchase price is allocated to the net assets of the acquired business at their respective fair values. Amounts allocated to in-process research and development are recorded at fair value and are considered indefinite-lived intangible assets subject to the impairment testing in accordance with the Company s impairment testing policy for indefinite-lived intangible assets as described above. As products in development are approved for sale, amounts will be allocated to product rights and will be amortized over their estimated useful lives. Definite-lived intangible assets are amortized over the expected life of the asset. The Company s fair value assessments are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates and the probability of achieving the estimated cash flows. The judgments made in determining the estimated fair value of in-process research and development, as well as asset lives, can materially impact our results of operations. There can be no assurances as to when, or if, future impairments may occur.

Share-based Compensation

Share-based compensation costs are recognized over the vesting period, using a straight-line method, based on the fair value of the instrument on the date of grant less an estimate for expected forfeitures. The Company uses the Black-Scholes valuation model to determine the fair value of

stock options and the market price on the grant date to value restricted stock. The Black-Scholes valuation model includes various assumptions, including the expected volatility, the expected life of the award, dividend yield and the risk-free interest rate. These assumptions involve inherent uncertainties based on market conditions which are generally outside the Company s control. Changes in these assumptions could have a material impact on share-based compensation costs recognized in the financial statements.

Table of Contents

The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the six months ended December 31, 2016 and 2015 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

	Six Months Ended	
	December 31, 2016	December 31, 2015
Risk-free interest rate	1.1%	1.7%
Expected volatility	55.6%	48.3%
Expected dividend yield	0.0%	0.0%
Forfeiture rate	6.5%	6.5%
Expected term	5.2 years	5.2 years

Expected volatility is based on the historical volatility of the price of our common shares during the historical period equal to the expected term of the option. The Company uses historical information to estimate the expected term, which represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period equal to the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The forfeiture rate assumption is the estimated annual rate at which unvested awards are expected to be forfeited during the vesting period. This assumption is based on our actual forfeiture rate on historical awards. Periodically, management will assess whether it is necessary to adjust the estimated rate to reflect changes in actual forfeitures or changes in expectations. Additionally, the expected dividend yield is equal to zero, as the Company has not historically issued and has no immediate plans to issue, a dividend.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The authoritative guidance is effective for annual reporting periods beginning after December 15, 2017. The Company is continuing to assess the impact this guidance will have on the consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Inventory Simplifying the Measurement of Inventory*. ASU 2015-11 requires inventory to be subsequently measured using the lower of cost and net realizable value, thereby eliminating the market value approach. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is applied prospectively. Early adoption is permitted. The Company does not believe this guidance will have a material impact on the consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations Simplifying the Accounting for Measurement-Period Adjustments*. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 also requires that the acquirer record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 is effective for reporting periods beginning after December 15, 2015 and is applied prospectively. Early adoption is permitted. The Company elected to early adopt ASU 2015-16 as of March 31, 2016.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes Balance Sheet Classification of Deferred Taxes.* ASU 2015-17 requires all deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. The guidance may be applied either prospectively or retrospectively. ASU 2015-17 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company does not believe this guidance will have a material impact on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases.* ASU 2016-02 requires an entity to recognize right-of-use assets and liabilities on its balance sheet for all leases with terms longer than 12 months. Lessees and lessors are required to disclose quantitative and qualitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period and requires a modified retrospective application, with early adoption permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

Table of Contents

In March 2016, the FASB issued ASU 2016-09, *Compensation Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 clarifies several aspects of accounting for share-based compensation including the accounting for excess tax benefits and deficiencies, accounting for forfeitures and the classification of excess tax benefits on the cash flow statement. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016 and in interim periods within those fiscal years, with early adoption permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows Classification of Certain Cash Receipts and Cash Payments.* ASU 2016-15 addresses how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2017. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

On November 25, 2015, in connection with the acquisition of KUPI, the Company entered into a Senior Secured Credit Facility, which was subsequently amended in June 2016. Based on the variable-rate debt outstanding at December 31, 2016, each 1/8% increase in interest rates would yield $1.4 million of incremental annual interest expense.

A mortgage loan with First National Bank of Cody has been consolidated in the Company s financial statements, along with the related land and building. The mortgage requires monthly principal and interest payments of $15 thousand. As of December 31, 2016 and June 30, 2016, the effective interest rate was 4.5% per annum. The mortgage is collateralized by the land and building with a net book value of $1.4 million. As of December 31, 2016, $804 thousand is outstanding under the mortgage loan.

The Company invests in equity securities, U.S. government agency securities and corporate bonds, which are exposed to market and interest rate fluctuations. The market value, interest and dividends earned on these investments may vary based on fluctuations in interest rate and market conditions.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Form 10-Q, management performed, with the participation of our Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that Lannett s disclosure controls and procedures were effective as of the end of the period covered by this report.

Change in Internal Control Over Financial Reporting

There has been no change in Lannett s internal control over financial reporting during the three and six months ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

48

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information pertaining to legal proceedings can be found in Note 13. Legal, Regulatory Matters and Contingencies of the Consolidated Financial Statements included in Part I, Item 1. of this Quarterly Report on Form 10-Q and is incorporated by reference herein.

ITEM 1A. RISK FACTORS

Lannett Company, Inc. s Annual Report on Form 10-K for the fiscal year ended June 30, 2016 includes a detailed description of its risk factors.

ITEM 6. EXHIBITS

(a) A list of the exhibits required by Item 601 of Regulation S-K to be filed as a part of this Form 10-Q is shown on the Exhibit Index filed herewith.

Table of Contents

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LANNETT COMPANY, INC.

Dated: February 3, 2017

By: /s/ Arthur P. Bedrosian
Arthur P. Bedrosian
Chief Executive Officer

Dated: February 3, 2017

By: /s/ Martin P. Galvan
Martin P. Galvan
Vice President of Finance,
Chief Financial Officer and Treasurer

Dated: February 3, 2017

By: /s/ G. Michael Landis
G. Michael Landis
Director of Finance and Principal Accounting Officer

Table of Contents

Exhibit Index

31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
101.INS	XBRL Instance Document	
101.SCH	XBRL Extension Schema Document	
101.CAL	XBRL Calculation Linkbase Document	
101.DEF	XBRL Definition Linkbase Document	
101.LAB	XBRL Label Linkbase Document	
101.PRE	XBRL Presentation Linkbase Document	