

LANNETT CO INC
Form 10-Q
May 08, 2018
[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2018

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
(State of Incorporation)

23-0787699
(I.R.S. Employer I.D. No.)

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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 No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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 April 30, 2018
Common stock, par value \$0.001 per share	38,014,150

Table of Contents

Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1.</u>	<u>FINANCIAL STATEMENTS</u>
	3
	4
	5
	6
	7
	8
<u>ITEM 2.</u>	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>
	28
<u>ITEM 3.</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>
	39
<u>ITEM 4.</u>	<u>CONTROLS AND PROCEDURES</u>
	39
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1.</u>	<u>LEGAL PROCEEDINGS</u>
	39
<u>ITEM 1A.</u>	<u>RISK FACTORS</u>
	39
<u>ITEM 6.</u>	<u>EXHIBITS</u>
	41

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) March 31, 2018	June 30, 2017
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 114,016	\$ 117,737
Investment securities	9,089	27,091
Accounts receivable, net	238,767	204,066
Inventories	133,290	122,604
Prepaid income taxes	16,563	16,703
Other current assets	10,045	6,592
Total current assets	521,770	494,793
Property, plant and equipment, net	267,398	243,148
Intangible assets, net	420,582	453,861
Goodwill	339,566	339,566
Deferred tax assets	18,713	52,753
Other assets	29,462	19,191
TOTAL ASSETS	\$ 1,597,491	\$ 1,603,312
<u>LIABILITIES</u>		
Current liabilities:		
Accounts payable	\$ 67,501	\$ 44,720
Accrued expenses	5,832	12,499
Accrued payroll and payroll-related expenses	9,318	4,833
Rebates payable	41,267	44,593
Royalties payable	9,540	3,015
Restructuring liability	3,328	5,431
Settlement liability		17,000
Short-term borrowings and current portion of long-term debt	66,845	60,117
Total current liabilities	203,631	192,208
Long-term debt, net	784,689	843,530
Other liabilities	2,199	6,452
TOTAL LIABILITIES	990,519	1,042,190
Commitments and Contingencies (Note 12 and 13)		
<u>STOCKHOLDERS' EQUITY</u>		
Common stock (\$0.001 par value, 100,000,000 shares authorized; 38,176,302 and 37,528,450 shares issued; 37,305,266, and 36,919,296 shares outstanding at March 31, 2018 and June 30, 2017, respectively)	38	37

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Additional paid-in capital	303,376	292,780
Retained earnings	317,823	277,774
Accumulated other comprehensive loss	(450)	(222)
Treasury stock (871,036 and 609,154 shares at March 31, 2018 and June 30, 2017, respectively)	(13,815)	(9,247)
Total stockholders' equity	606,972	561,122
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,597,491	\$ 1,603,312

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 March 31,		Nine months ended March 31,	
	2018	2017	2018	2017
Net sales	\$ 174,386	\$ 165,720	\$ 513,652	\$ 498,223
Settlement agreement		(4,000)		(4,000)
Total net sales	174,386	161,720	513,652	494,223
Cost of sales	99,036	81,553	267,503	227,527
Amortization of intangibles	8,293	7,737	23,971	24,361
Gross profit	67,057	72,430	222,178	242,335
Operating expenses:				
Research and development expenses	2,730	8,340	20,861	30,650
Selling, general and administrative expenses	14,112	17,629	61,643	56,958
Acquisition and integration-related expenses		1,256	83	3,674
Restructuring expenses	1,421	1,568	2,983	5,332
Loss on sale of intangible asset	15,514		15,514	
Intangible asset impairment charges				88,084
Total operating expenses	33,777	28,793	101,084	184,698
Operating income	33,280	43,637	121,094	57,637
Other income (loss):				
Investment income	719	1,037	4,208	3,085
Interest expense	(22,842)	(22,373)	(64,440)	(68,700)
Other	(662)	(35)	2,473	(298)
Total other loss	(22,785)	(21,371)	(57,759)	(65,913)
Income (loss) before income tax	10,495	22,266	63,335	(8,276)
Income tax expense (benefit)	(2,275)	7,337	23,286	(2,003)
Net income (loss)	12,770	14,929	40,049	(6,273)
Less: Net income attributable to noncontrolling interest				34
Net income (loss) attributable to Lannett Company, Inc.	\$ 12,770	\$ 14,929	\$ 40,049	\$ (6,307)
Earnings (loss) per common share attributable to Lannett Company, Inc.:				
Basic	\$ 0.34	\$ 0.41	\$ 1.08	\$ (0.17)
Diluted	\$ 0.33	\$ 0.40	\$ 1.05	\$ (0.17)
Weighted average common shares outstanding:				
Basic	37,136,945	36,849,208	37,064,781	36,785,829
Diluted	38,287,005	37,752,304	38,112,193	36,785,829

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

Table of Contents

LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

(In thousands)

	Three months ended March 31,		Nine months ended March 31,	
	2018	2017	2018	2017
Net income (loss)	\$ 12,770	\$ 14,929	\$ 40,049	\$ (6,273)
Other comprehensive income (loss), before tax:				
Foreign currency translation gain (loss)	(103)	76	(228)	114
Total other comprehensive income (loss), before tax	(103)	76	(228)	114
Income tax related to items of other comprehensive income				
Total other comprehensive income (loss), net of tax	(103)	76	(228)	114
Comprehensive income (loss)	12,667	15,005	39,821	(6,159)
Less: Total comprehensive income attributable to noncontrolling interest				34
Comprehensive income (loss) attributable to Lannett Company, Inc.	\$ 12,667	\$ 15,005	\$ 39,821	\$ (6,193)

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)

	Common Stock		Additional	Retained	Accumulated	Treasury	Stockholders
	Shares	Amount	Paid-In	Earnings	Other	Stock	Equity
	Issued		Capital		Comprehensive		Attributable to
					Loss		Lannett Co., Inc
Balance, June 30, 2017	37,528	\$ 37	\$ 292,780	\$ 277,774	\$ (222)	\$ (9,247)	\$ 561,122
Shares issued in connection with share-based compensation plans	648	1	3,578				3,579
Share-based compensation			7,018				7,018
Purchase of treasury stock						(4,568)	(4,568)
Other comprehensive loss, net of tax					(228)		(228)
Net income				40,049			40,049
Balance, March 31, 2018	38,176	\$ 38	\$ 303,376	\$ 317,823	\$ (450)	\$ (13,815)	\$ 606,972

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)

	Nine Months Ended March 31,	
	2018	2017
OPERATING ACTIVITIES:		
Net income (loss)	\$ 40,049	\$ (6,273)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	40,638	41,556
Deferred income tax expense (benefit)	34,040	(11,217)
Share-based compensation	7,018	5,962
Excess tax benefits on share-based compensation awards		(725)
Intangible asset impairment charge		88,084
Loss on sale of assets	777	296
Loss on sale of intangible asset	15,514	
Gain on investment securities	(3,201)	(2,473)
Amortization of debt discount and other debt issuance costs	17,294	15,548
Settlement agreement provision		4,000
Other noncash expenses	4	1,889
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable, net	(34,701)	(9,470)
Inventories	(10,686)	(8,913)
Prepaid income taxes/Income taxes payable	(77)	(9,891)
Other assets	(7,972)	(6,480)
Rebates payable	(3,326)	12,773
Royalties payable	6,525	(1,196)
Restructuring liability	(2,103)	840
Settlement liability		(3,000)
Accounts payable	5,781	11,567
Accrued expenses	(6,667)	(1,785)
Accrued payroll and payroll-related expenses	4,485	(633)
Net cash provided by operating activities	103,392	120,459
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(41,147)	(32,116)
Proceeds from sale of property, plant and equipment	35	38
Advance to variable interest entity	(9,955)	
Purchases of intangible assets	(7,038)	
Proceeds from sale of investment securities	83,833	44,571
Purchase of investment securities	(62,630)	(50,538)
Net cash used in investing activities	(36,902)	(38,045)
FINANCING ACTIVITIES:		
Repayments of short-term borrowings and long-term debt	(68,994)	(139,927)
Purchase of noncontrolling interest		(1,500)
Acquisition-related contingent consideration		(35,000)
Proceeds from issuance of stock	3,579	2,276
Excess tax benefits on share-based compensation awards		725

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Purchase of treasury stock	(4,568)	(1,840)
Net cash used in financing activities	(69,983)	(175,266)
Effect on cash and cash equivalents of changes in foreign exchange rates	(228)	114
NET DECREASE IN CASH AND CASH EQUIVALENTS	(3,721)	(92,738)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	117,737	224,769
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 114,016	\$ 132,031
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid (net of capitalized interest of \$1.6 million and \$1.1 million for the nine months ended March 31, 2018 and 2017, respectively)	\$ 46,740	\$ 51,422
Income taxes paid (received)	\$ (6,760)	\$ 19,116
Credits issued pursuant to a Settlement Agreement	\$ 17,000	\$ 2,500

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 nine months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2018. 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, 2017. The Consolidated Balance Sheet for the fiscal year ended June 30, 2017 was 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 (UCB). 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 former 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. In December 2017, the Company legally dissolved Realty. Additionally, all intercompany accounts and transactions have been eliminated.

Table of Contents

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.

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 and share-based compensation. 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

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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. Realized and unrealized 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.

Table of Contents

Inventories

Inventories are stated at the lower of cost and net realizable value 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, expiration date and estimated sales forecasts.

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.

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 lives of the related assets. 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. The Company first determines the fair value of our reporting unit (generic pharmaceuticals). If the net book value of our reporting unit exceeds its fair value, the difference will be recorded as a goodwill impairment, not to exceed the carrying amount of goodwill. 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 can materially impact our results of operations.

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 nine months ended March 31, 2018 and 2017:

(In thousands) Medical Indication	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2018	2017	2018	2017
Antibiotic	\$ 3,801	\$ 4,474	\$ 10,701	\$ 13,047
Anti-Psychosis	9,336	14,433	47,127	47,119
Cardiovascular	18,514	14,815	39,955	39,484
Central Nervous System	8,395	11,124	24,137	32,028
Gallstone	3,828	11,157	15,674	37,465
Gastrointestinal	16,562	19,441	46,171	56,470
Glaucoma	875	4,868	5,706	15,962
Migraine	12,888	7,043	43,387	22,066
Muscle Relaxant	3,299	3,673	10,309	10,208
Pain Management	6,594	6,085	18,483	20,132
Respiratory	2,324	4,256	6,200	9,426
Thyroid Deficiency	69,975	44,999	185,983	130,267
Urinary	33	2,619	5,870	12,413
Other	12,376	14,555	38,178	36,870
Contract manufacturing revenue	5,586	2,178	15,771	15,266
Net sales	174,386	165,720	513,652	498,223
Settlement agreement		(4,000)		(4,000)
Total net sales	\$ 174,386	\$ 161,720	\$ 513,652	\$ 494,223

Customer, Supplier and Product Concentration

The following table presents the percentage of total net sales, for the three and nine months ended March 31, 2018 and 2017, 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 total net sales in any of those periods:

Product 1	For the Three Months Ended March 31,		For the Nine Months Ended March 31,	
	2018	2017	2018	2017
Product 1	40%	28%	36%	26%

The following table presents the percentage of total net sales, for the three and nine months ended March 31, 2018 and 2017, for certain of the Company's customers which accounted for at least 10% of total net sales in any of those periods:

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	For the Three Months Ended		For the Nine Months Ended	
	2018	2017	2018	2017
Customer A	32%	27%	27%	28%
Customer B	15%	23%	18%	21%

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 37% and 33% of the Company's inventory purchases during the three months ended March 31, 2018 and 2017, respectively. Purchases of finished goods inventory from JSP accounted for approximately 36% and 37% of the Company's inventory purchases during the nine months ended March 31, 2018 and 2017, respectively. See Note 21 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 and collection is reasonably assured. 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 estimated 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 \$218.5 million and \$175.8 million at March 31, 2018 and June 30, 2017, respectively. Rebates payable at March 31, 2018 and June 30, 2017 totaled \$41.3 million and \$44.6 million, respectively, for certain rebate programs, primarily related to Medicare Part D and 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 Expenses

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 included in the Consolidated Statements of Operations under the Selling, general and administrative expense line item.

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, the stock price on the grant date to value restricted stock and the Monte-Carlo simulation model to determine the fair value of performance-based shares. The Black-Scholes valuation and Monte-Carlo simulation models include various assumptions, including the expected volatility, the expected life of the award, dividend yield and the risk-free interest rate as well as performance assumptions of peer companies. 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 consolidated financial statements.

Self-Insurance

Effective January 1, 2017, the Company self-insures for certain employee medical and prescription benefits. The Company also maintains stop loss coverage with third party insurers to limit its total liability exposure. The liability for self-insured risks is primarily calculated using independent third party actuarial valuations which take into account actual claims, claims growth and claims incurred but not yet reported. Actual experience, including claim frequency and severity as well as health-care inflation, could result in different liabilities than the amounts currently recorded. The liability for self-insured risks under this plan as of March 31, 2018 totaled \$3.4 million and was not material to the consolidated financial position of the Company as of June 30, 2017.

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.

On December 22, 2017, President Trump signed the Tax Cut and Jobs Act legislation (2017 Tax Reform) into law, which included a broad range of tax reform provisions affecting businesses, including corporate tax rates, business deductions and international tax provisions. Many of these provisions significantly differ from current U.S. tax law, resulting in pervasive financial reporting implications. As a result of the new law, the SEC issued Staff Accounting Bulletin No. 118 (SAB 118) to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of 2017 Tax Reform. SAB 118 requires registrants to report the tax effects of 2017 Tax Reform, inclusive of provisional amounts for which the accounting is incomplete but a reasonable estimate can be determined. SAB 118 also allows for a measurement period of up to one year in cases where a registrant reports a provisional amount or is unable to reasonably estimate the impact of 2017 Tax Reform.

Earnings (Loss) Per Common Share

Basic earnings (loss) per common share attributable to the Company 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 (loss) per common share attributable to the Company 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 consist of stock options, unvested restricted stock, performance-based shares 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 Financial Accounting Standards Board (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. Based on a preliminary review of the contracts representing a substantial portion of our revenues, the Company does not expect the guidance to have a material impact on our disclosures or the timing and recognition of our revenues. The majority of the Company's revenues is generated from product sales and based on the Company's initial assessment, it currently does not anticipate a significant impact to the revenue and disclosures related to these arrangements.

Table of Contents

The Company is in the process of establishing and documenting key accounting policies, conducting training and education throughout the organization, and evaluating impacts on business processes, information technology, and controls resulting from the adoption of this new standard. The Company also continues to accumulate the necessary information to determine the cumulative effects of the accounting change to be recorded upon adoption of the guidance. The Company intends to use the modified retrospective approach upon implementation.

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. The guidance became effective for the Company in the first quarter of Fiscal 2018. Accordingly, the Company currently presents all deferred tax assets and liabilities as noncurrent on the balance sheet. All prior period amounts have also been reclassified to conform with the current year presentation.

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 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. 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 \$19.0 million in restructuring charges for actions that have been announced or communicated since the 2016 Restructuring Program began. Of this amount, approximately \$10.0 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 nine months ended March 31, 2018 and 2017 were as follows:

	For the Three Months Ended		For the Nine Months Ended	
	March 31,		March 31,	
(In thousands)	2018	2017	2018	2017

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Employee separation costs (credits)	\$	339	\$	679	\$	(41)	\$	2,840
Facility closure costs		1,082		889		3,024		2,492
Total	\$	1,421	\$	1,568	\$	2,983	\$	5,332

In the first quarter of Fiscal 2018, the Company decided to retain certain employees who were previously included in the 2016 Restructuring Program. As a result, the Company reversed all previous charges incurred related to these employees.

A reconciliation of the changes in restructuring liabilities associated with the 2016 Restructuring Program from June 30, 2017 through March 31, 2018 is set forth in the following table:

(In thousands)	Employee Separation Costs	Contract Termination Costs	Facility Closure Costs	Total
Balance at June 30, 2017	\$ 5,431	\$	\$	\$ 5,431
Restructuring Charges (Credits)	(41)		3,024	2,983
Payments	(2,062)		(3,024)	(5,086)
Balance at March 31, 2018	\$ 3,328	\$	\$	\$ 3,328

Table of Contents**Note 5. Accounts Receivable**

Accounts receivable consisted of the following components at March 31, 2018 and June 30, 2017:

(In thousands)	March 31, 2018		June 30, 2017	
Gross accounts receivable	\$	458,878	\$	380,653
Less Chargebacks reserve		(113,446)		(79,537)
Less Rebates reserve		(34,784)		(43,023)
Less Returns reserve		(47,253)		(42,135)
Less Other deductions		(23,026)		(11,096)
Less Allowance for doubtful accounts		(1,602)		(796)
Accounts receivable, net	\$	238,767	\$	204,066

For the three months ended March 31, 2018, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns and other deductions of \$323.1 million, \$72.0 million, \$7.1 million, and \$23.7 million, respectively. For the three months ended March 31, 2017, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns and other deductions of \$247.7 million, \$75.9 million, \$6.6 million, and \$12.6 million, respectively.

For the nine months ended March 31, 2018, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of \$798.0 million, \$228.1 million, \$21.7 million, and \$52.3 million, respectively. For the nine months ended March 31, 2017, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of \$664.0 million, \$218.9 million, \$21.4 million, and \$42.0 million, respectively.

Note 6. Inventories

Inventories at March 31, 2018 and June 30, 2017 consisted of the following:

(In thousands)	March 31, 2018		June 30, 2017	
Raw materials	\$	63,325	\$	57,442
Work-in-process		18,009		15,676
Finished goods		51,956		49,486
Total	\$	133,290	\$	122,604

Inventories were reduced by \$6.1 million and \$4.5 million at March 31, 2018 and June 30, 2017, respectively, for excess and obsolete inventory amounts. During the three months ended March 31, 2018 and 2017, the Company recorded provisions for excess and obsolete inventory of \$4.0 million and \$2.3 million, respectively. During the nine months ended March 31, 2018 and 2017, the Company recorded provisions for excess and obsolete inventory of \$8.3 million and \$7.7 million, respectively.

Note 7. Property, Plant and Equipment

Property, plant and equipment, net at March 31, 2018 and June 30, 2017 consisted of the following:

(In thousands)	Useful Lives	March 31, 2018		June 30, 2017	
Land		\$	6,191	\$	6,191
Building and improvements	10 - 39 years		108,035		108,730
Machinery and equipment	5 - 10 years		147,561		142,086
Furniture and fixtures	5 - 7 years		3,830		2,953
Less: accumulated depreciation			(85,565)		(71,461)
			180,052		188,499
Construction in progress			87,346		54,649
Property, plant and equipment, net		\$	267,398	\$	243,148

Depreciation expense for the three months ended March 31, 2018 and 2017 was \$5.0 million and \$5.5 million, respectively. Depreciation expense for the nine months ended March 31, 2018 and 2017 was \$16.1 million.

Property, plant and equipment, net included amounts held in foreign countries in the amount of \$1.1 million and \$1.0 million at March 31, 2018 and June 30, 2017, respectively.

Table of Contents**Note 8. 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 financial assets and liabilities measured at fair value at March 31, 2018 and June 30, 2017, were as follows:

(In thousands)	March 31, 2018				Total
	Level 1	Level 2	Level 3		
<u>Assets</u>					
Investment securities	\$ 9,089	\$	\$	\$	\$ 9,089
Total Assets	\$ 9,089	\$	\$	\$	\$ 9,089

(In thousands)	June 30, 2017			Total
	Level 1	Level 2	Level 3	
Assets				
Investment securities	\$ 27,091	\$	\$	\$ 27,091
Total Assets	\$ 27,091	\$	\$	\$ 27,091

Note 9. Investment Securities

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

Table of Contents

The Company had a net gain on investment securities of \$368 thousand during the three months ended March 31, 2018, which included an unrealized loss related to securities still held at March 31, 2018 of \$1.6 million. The Company had a net gain on investment securities of \$776 thousand during the three months ended March 31, 2017, which included an unrealized gain related to securities still held at March 31, 2017 of \$103 thousand.

The Company had a net gain on investment securities of \$3.2 million during the nine months ended March 31, 2018, which included an unrealized loss related to securities still held at March 31, 2018 of \$421 thousand. The Company had a net gain on investment securities of \$2.5 million during the nine months ended March 31, 2017, which included an unrealized gain related to securities still held at March 31, 2017 of \$660 thousand.

Note 10. Intangible Assets

Intangible assets, net as of March 31, 2018 and June 30, 2017, consisted of the following:

(In thousands)	Weighted Avg. Life (Yrs.)	Gross Carrying Amount		Accumulated Amortization		Intangible Assets, Net	
		March 31, 2018	June 30, 2017	March 31, 2018	June 30, 2017	March 31, 2018	June 30, 2017
Definite-lived:							
Cody Labs import license	15	\$ 582	\$ 582	\$ (376)	\$ (347)	\$ 206	\$ 235
KUPI product rights	15	416,154	434,000	(62,904)	(43,286)	353,250	390,714
KUPI trade name	2	2,920	2,920	(2,920)	(2,338)		582
KUPI other intangible assets	15	19,000	19,000	(2,978)	(2,028)	16,022	16,972
Silarx product rights	15	10,000	10,000	(1,889)	(1,389)	8,111	8,611
Other product rights	11	7,691	653	(1,147)	(355)	6,544	298
Total definite-lived		\$ 456,347	\$ 467,155	\$ (72,214)	\$ (49,743)	\$ 384,133	\$ 417,412
Indefinite-lived:							
KUPI in-process research and development		\$ 18,000	\$ 18,000			\$ 18,000	\$ 18,000
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	36,449			36,449	36,449
Total intangible assets, net		\$ 492,796	\$ 503,604	\$ (72,214)	\$ (49,743)	\$ 420,582	\$ 453,861

In the third quarter of Fiscal 2018, the Company sold an intangible asset related to a product right acquired as part of the KUPI acquisition. In connection with the transaction, the Company recorded a \$15.5 million loss on sale of the intangible asset, which had a carrying value of \$15.8 million at the time of sale.

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In February 2018, the Company completed the acquisition of five products from UCB for \$5.0 million which is included within the Other product rights category of intangible assets.

For the three months ended March 31, 2018 and 2017, the Company recorded amortization expense of \$8.3 million and \$8.1 million, respectively. For the nine months ended March 31, 2018 and 2017, the Company recorded amortization expense of \$24.6 million and \$25.5 million, respectively.

Future annual amortization expense consisted of the following as of March 31, 2018:

(In thousands)	
Fiscal Year Ending June 30,	Annual Amortization Expense
2018	\$ 14,307
2019	30,923
2020	30,082
2021	30,082
2022	30,082
Thereafter	248,657
	\$ 384,133

Table of Contents**Note 11. Long-Term Debt**

Long-term debt, net consisted of the following:

(In thousands)	March 31, 2018	June 30, 2017
Term Loan A due 2020	\$ 234,151	\$ 254,375
Unamortized discount and other debt issuance costs	(11,457)	(16,238)
Term Loan A, net	222,694	238,137
Term Loan B due 2022	679,847	727,881
Unamortized discount and other debt issuance costs	(51,007)	(63,106)
Term Loan B, net	628,840	664,775
Revolving Credit Facility due 2020		
Other		735
Total debt, net	851,534	903,647
Less short-term borrowings and current portion of long-term debt	(66,845)	(60,117)
Total long-term debt, net	\$ 784,689	\$ 843,530

During the third quarter of Fiscal 2018, the Company made a voluntary payment of \$25.0 million against its outstanding Term Loan A and Term Loan B debt. As a result of the prepayment, the Company wrote off a portion of the related debt issuance costs totaling \$2.6 million which was included in interest expense.

Long-term debt amounts due, for the twelve month periods ending March 31 are as follows:

(In thousands)	Amounts Payable to Institutions
2019	\$ 66,845
2020	66,845
2021	218,496
2022	39,345
2023	522,467
Total	\$ 913,998

Note 12. Legal, Regulatory Matters and ContingenciesConnecticut 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 the 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

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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. In December 2016, the Connecticut Attorney General, joined by numerous other State Attorneys General, filed a civil complaint alleging that six pharmaceutical companies engaged in anti-competitive behavior related to doxycycline hyclate and gliburide. The Company was not named in the action and does not compete on the products that formed the basis of the complaint. The complaint was later transferred for pretrial purposes to the United States District Court for the Eastern District of Pennsylvania as part of a multidistrict litigation captioned *In re: Generic Pharmaceuticals Pricing Antitrust Litigation*. On October 31, 2017, the state Attorneys General filed a motion in the District Court for leave to amend their complaint to add numerous additional defendants, including the Company, and claims relating to 13 additional drugs. The claim relating to Lannett involves alleged price-fixing for one drug, doxycycline monohydrate, but does not involve the pricing for digoxin. The state Attorneys General also allege that all defendants were part of an overarching, industry-wide conspiracy to allocate markets and fix prices generally. All of the existing and proposed defendants, including the Company, have opposed the motion of the state Attorneys General. The motion is pending.

The Company maintains that it acted in compliance with all applicable laws and regulations and continues to cooperate with the Connecticut Attorney General investigation.

Table of Contents

Federal Investigation into the Generic Pharmaceutical Industry

The Company and certain affiliated individuals and customers have been served with grand jury subpoenas 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 it 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. 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 March 31, 2018 and June 30, 2017, the Company's best estimate of the liability for potential overcharges was 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.

AWP Litigation

The Company and some of our competitors have been named as defendants in two 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 first lawsuit, filed in the United States District Court for the Eastern of Pennsylvania, was dismissed on September 25, 2017

(the Federal Action). The second lawsuit, pending in the Philadelphia (Pennsylvania) County Court of Common Pleas, remains stayed. 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.

EPA Violation Notice

On July 13, 2017, the United States Department of Environmental Protection Agency (EPA) sent a Finding of Violation to KUPI alleging several violations of national emissions standards for hazardous air pollutants at KUPI s Seymour, Indiana facility. The EPA is giving the company the opportunity to discuss the matter with the agency before filing a formal complaint or assessing fines with respect to the alleged violations. The Company is conducting an investigation into the matter and cannot reasonably predict the outcome of any potential EPA action at this time.

Private Antitrust and Consumer Protection Litigation

The Company and certain competitors have been named as defendants in a number of lawsuits filed in 2016 and 2017 alleging that the Company and certain generic pharmaceutical manufacturers have conspired to fix prices of generic digoxin, levothyroxine, ursodiol and baclofen. These cases are part of a larger group of more than 100 lawsuits generally alleging that over 30 generic pharmaceutical manufacturers and distributors conspired to fix prices for at least 18 different generic drugs in violation of the federal Sherman Act, various state antitrust laws, and various state consumer protection statutes. The United States also has been granted leave to intervene in the cases. On April 6, 2017, the Judicial Panel on Multidistrict Litigation (the JPML) ordered that all of the cases alleging price-fixing for generic drugs be consolidated for pretrial proceedings in the United States District Court for the Eastern District of Pennsylvania under the caption *In re: Generic Pharmaceuticals Pricing Antitrust Litigation*. The various plaintiffs are grouped into three categories Direct Purchaser Plaintiffs, End Payer Plaintiffs, and Indirect Reseller Purchasers and filed Consolidated Amended Complaints (CACs) against the Company and the other defendants on August 15, 2017.

Table of Contents

The CACs naming the Company as a defendant involve generic digoxin, levothyroxine, ursodiol and baclofen. Pursuant to a court-ordered schedule grouping the 18 different drug cases into three separate tranches, the Company and other generic pharmaceutical manufacturer defendants on October 6, 2017 filed joint and individual motions to dismiss the CACs involving the six drugs in the first tranche, including digoxin. Those motions are pending.

On January 22, 2018, three opt-out direct purchasers filed a complaint alleging an overarching conspiracy and individual conspiracies on behalf of the Company and numerous other defendants to fix the prices of and allocate markets for at least 30 different drugs, including digoxin, doxycycline, levothyroxine, ursodiol and baclofen. None of the defendants, including the Company, has responded yet to the complaint.

In addition to the lawsuits brought by private plaintiffs, the Attorneys General of 45 states, the District of Columbia and Puerto Rico have filed *parens patriae* lawsuits alleging price-fixing conspiracies by various generic pharmaceutical manufacturers. The JPML has consolidated the suits by the state Attorneys General in the Eastern District of Pennsylvania as part of the multidistrict litigation. The original lawsuits did not name the Company, but the state Attorneys General on October 31, 2017 filed a motion with the District Court for leave to amend their complaint to add numerous additional defendants, including the Company, and claims relating to 13 additional drugs. The claim relating to Lannett involves alleged price-fixing for one drug, doxycycline monohydrate, although the state Attorneys General allege that all defendants were part of an overarching, industry-wide conspiracy to allocate markets and fix prices generally. All of the existing and proposed defendants, including the Company, have opposed the motion of the state Attorneys General. The motion is pending.

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.

Shareholder Litigation

In November 2016, a putative class action lawsuit was filed against the Company and two of its officers claiming that the Company damaged the purported class by including in its securities filings false and misleading statements regarding the Company's drug pricing methodologies and internal controls. A first amended complaint was filed in May 2017, and the Company filed a motion to dismiss the amended complaint in September 2017. In December 2017, counsel for the putative class filed a second amended complaint, and the Court denied as moot the Company's motion to dismiss the first amended complaint. The Company filed a motion to dismiss the second amended complaint in February 2018. 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.

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.

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.

Table of Contents

A trial was conducted in September 2016. The Court issued its decision on March 29, 2017, finding that Lannett did not prove that the patents at issue are invalid. The Company has appealed the decision. All briefing to the appellate court has been submitted, and oral argument before the appellate court was conducted on April 5, 2018. A final decision of the appellate court is expected in 2018.

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, and an amended answer to the complaint.

A settlement agreement was reached and the Court dismissed the lawsuit in October 2017. Pursuant to the settlement agreement, the Company entered into a license agreement that permits Lannett to manufacture and market in the U.S. its generic thalidomide product as of August 1, 2019 or earlier under certain circumstances.

SUPREP®

The Company filed ANDA No. 209941 with the Food and Drug Administration seeking approval to sell a bowel preparation oral solution (the Company's Oral Solution), along with a paragraph IV certification, alleging that US Patent 6,946,149 associated with the Suprep® bowel preparation kit would not be infringed by the Company's Oral Solution and/or that the patent is invalid.

In March 2017, Braintree Laboratories, Inc. (Braintree) filed a patent infringement lawsuit in the United States District Court for the District of Delaware (C.A. No. 1:17-cv-00293-GMS), alleging that the Company's filing of ANDA No. 209941 constitutes an act of patent infringement and seeking a declaration that the patent at issue was infringed by the submission of ANDA No. 209941. The Company answered the complaint denying infringement and raising invalidity as a defense, and has filed counterclaims seeking a declaration of non-infringement and invalidity. On July 28, 2017, the Company filed a motion for judgment on the pleadings, seeking a ruling that its ANDA product does not infringe the Braintree patent and seeking judgment as a matter of law. Braintree opposed the motion and has alternatively requested that the Court delay its decision on the motion until discovery is taken. The Company opposed Braintree's request to delay the decision. While the motions were pending, the parties agreed to resolve this dispute. The parties signed a confidential settlement agreement and filed a Stipulation of Dismissal Without Prejudice on December 13, 2017. On December 17, 2017, the Court granted the parties' Stipulation of Dismissal Without Prejudice. In connection with the settlement agreement, the Company received \$3.5 million, which is included in Other Income within the Consolidated Statements of Operations.

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.

Table of Contents**Note 13. 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 2018 and the twelve month periods ending June 30 thereafter are as follows:

(In thousands)	Amounts Due	
Remainder of 2018	\$	437
2019		1,835
2020		1,855
2021		1,406
2022		1,080
Thereafter		5,238
Total	\$	11,851

Other Commitment

During the third quarter of Fiscal 2017, the Company signed an agreement with a company operating in the pharmaceutical business, under which the Company agreed to provide up to \$15.0 million in revolving loans for the purpose of expansion and other business needs. The decision to provide any portion of the revolving loan is at the Company's sole discretion. At any time after the outstanding revolving loan balance is equal to or greater than \$7.5 million, the Company has the option to convert the first \$7.5 million into a 50% ownership interest in the entity. As of March 31, 2018, \$10.9 million was outstanding under the revolving loan. The board of the entity is comprised of five members, two of which are employees of the Company. Based on the guidance set forth in ASC 810-10 *Consolidation*, the Company has concluded that it has a variable interest in the entity. However, the Company is not the primary beneficiary to the entity and as such, is not required to consolidate the entity's results of operations.

Note 14. Accumulated Other Comprehensive Loss

The Company's Accumulated Other Comprehensive Loss was comprised of the following components as of March 31, 2018 and 2017:

(In thousands)	March 31, 2018	March 31, 2017
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Foreign Currency Translation			
Beginning Balance, June 30	\$	(222)	\$ (295)
Net gain (loss) on foreign currency translation (net of tax of \$0 and \$0)		(228)	114
Reclassifications to net income (net of tax of \$0 and \$0)			
Other comprehensive income (loss), net of tax		(228)	114
Ending Balance, March 31		(450)	(181)
Total Accumulated Other Comprehensive Loss	\$	(450)	\$ (181)

Note 15. Earnings (Loss) Per Common Share

A dual presentation of basic and diluted earnings (loss) 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 (loss) 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 (loss) per common share is computed using the treasury stock method and includes the effect of potential dilution from the exercise of outstanding stock options, a warrant and treats unvested restricted stock and performance-based shares as if they 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 (loss) per common share was as follows:

Table of Contents

(In thousands, except share and per share data)	Three Months Ended March 31,	
	2018	2017
Net income attributable to Lannett Company, Inc.	\$ 12,770	\$ 14,929
Basic weighted average common shares outstanding	37,136,945	36,849,208
Effect of potentially dilutive stock options, warrants and restricted stock awards	1,150,060	903,096
Diluted weighted average common shares outstanding	38,287,005	37,752,304
Earnings per common share attributable to Lannett Company, Inc.:		
Basic	\$ 0.34	\$ 0.41
Diluted	\$ 0.33	\$ 0.40

(In thousands, except share and per share data)	Nine Months Ended March 31,	
	2018	2017
Net income (loss) attributable to Lannett Company, Inc.	\$ 40,049	\$ (6,307)
Basic weighted average common shares outstanding	37,064,781	36,785,829
Effect of potentially dilutive stock options, warrants and restricted stock awards	1,047,412	
Diluted weighted average common shares outstanding	38,112,193	36,785,829
Earnings (loss) per common share attributable to Lannett Company, Inc.:		
Basic	\$ 1.08	\$ (0.17)
Diluted	\$ 1.05	\$ (0.17)

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the three months ended March 31, 2018 and 2017 was 3.0 million. The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the nine months ended March 31, 2018 and 2017 was 3.0 million and 4.4 million, respectively.

Note 16. Warrant

In connection with the KUPI acquisition on November 25, 2015, 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 17. Share-Based Compensation

At March 31, 2018, 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 1.5 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 March 31, 2018, there was \$10.6 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.

Table of Contents**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 nine months ended March 31, 2018 and 2017:

	Nine Months Ended	
	March 31, 2018	March 31, 2017
Risk-free interest rate	2.12%	1.1%
Expected volatility	57.6%	55.6%
Expected dividend yield	%	%
Forfeiture rate	6.5%	6.5%
Expected term (in years)	5.4 years	5.2 years
Weighted average fair value	\$ 11.25	\$ 15.33

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.

A stock option roll-forward as of March 31, 2018 and changes during the nine 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, 2017	1,475	\$ 18.02	\$ 12,212	5.7
Granted	50	\$ 21.43		
Exercised	(404)	\$ 7.13	\$ 3,897	
Forfeited, expired or repurchased	(20)	\$ 32.31		
Outstanding at March 31, 2018	1,101	\$ 21.93	\$ 4,205	5.6
Vested and expected to vest at March 31, 2018	1,096	\$ 21.92	\$ 4,205	5.6
Exercisable at March 31, 2018	1,044	\$ 21.60	\$ 4,205	5.4

Restricted Stock

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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 5.6% and 6.5% for the nine months ended March 31, 2018 and 2017, respectively.

A summary of restricted stock awards as of March 31, 2018 and changes during the nine months then ended, is presented below:

(In thousands, except for weighted average price and life data)	Awards	Weighted Average Grant - date Fair Value	Aggregate Intrinsic Value
Non-vested at June 30, 2017	334	\$ 30.71	
Granted	588	\$ 18.24	
Vested	(177)	\$ 31.30	\$ 3,901
Forfeited	(57)	\$ 21.70	
Non-vested at March 31, 2018	688	\$ 20.63	

Table of Contents***Performance-Based Shares***

On September 22, 2017, the Company approved and granted performance-based awards to certain key executives. The stock-settled awards will cliff vest based on relative Total Shareholder Return (TSR) over a three-year period. The Company measures share-based compensation cost for TSR awards using a Monte-Carlo simulation model.

A summary of performance-based share awards as of March 31, 2018 and changes during the nine months then ended, is presented below:

(In thousands, except for weighted average price and life data)	Awards	Weighted Average Grant - date Fair Value	Aggregate Intrinsic Value
Non-vested at June 30, 2017		\$	
Granted	47	\$ 25.58	
Vested	(21)	\$ 25.58	\$ 500
Forfeited		\$	
Non-vested at March 31, 2018	26	\$ 25.58	

In connection with the termination of the employment of Arthur P. Bedrosian, the Company's former Chief Executive Officer, the Company entered into a separation agreement pursuant to which he received certain benefits including, among others, accelerated vesting of his outstanding equity awards.

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 nine months ended March 31, 2018 and 2017, 46 thousand shares and 43 thousand shares were issued under the ESPP, respectively. As of March 31, 2018, 588 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:

(In thousands)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Selling, general and administrative expenses	\$ 1,638	\$ 1,345	\$ 5,350	\$ 4,568

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Research and development expenses		149		175		477		500
Cost of sales		478		269		1,191		894
Total	\$	2,265	\$	1,789	\$	7,018	\$	5,962
Tax benefit at statutory rate	\$	668	\$	653	\$	2,070	\$	2,176

Note 18. 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 March 31, 2018 and 2017 were \$675 thousand and \$527 thousand, respectively. Contributions to the Plan during the nine months ended March 31, 2018 and 2017 were \$1.7 million and \$1.6 million, respectively.

Table of Contents

Note 19. 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 benefit for the three months ended March 31, 2018 was \$2.3 million compared to income tax expense of \$7.3 million for the three months ended March 31, 2017. The effective tax rates for the three months ended March 31, 2018 and 2017 were (21.7)% and 33.0%, respectively. The federal, state and local income tax expense for the nine months ended March 31, 2018 was \$23.3 million compared to income tax benefit of \$2.0 million for the nine months ended March 31, 2017. The effective tax rates were 36.8% and 24.2%, respectively.

The effective tax rate for the nine months ended March 31, 2018 was higher compared to the same prior-year period primarily due to 2017 Tax Reform which was signed into law on December 22, 2017. Among numerous provisions included in the new law was the reduction of the statutory corporate federal income tax rate from 35% to 21%. In the second quarter of Fiscal 2018, the Company applied the newly enacted corporate federal income tax rate of 21% resulting in an approximately \$11.1 million revaluation of the Company's net long term deferred tax assets which are expected to reverse in future periods. During the third quarter of Fiscal 2018, the Company revised its provisional calculation for timing items related to the filing of its Fiscal 2017 tax return. As a result, the Company reduced the previously recorded revaluation amount to \$8.1 million in the third quarter of Fiscal 2018. The increase in the effective tax rate as a result of the revaluation was partially offset by a lower blended federal statutory tax rate of approximately 28.0% as compared to 35.0% in the same prior-year period. This resulted in an approximately \$4.6 million income tax benefit for the nine months ended March 31, 2018.

The effective tax rate for the three months ended March 31, 2018 was lower compared to the same prior-year period primarily due to the impact for timing items related to the filing of the Company's Fiscal 2017 tax return discussed above. The lower blended federal statutory tax rate of approximately 28.0% due to 2017 Tax Reform also contributed to a lower effective tax rate. This resulted in an approximately \$763 thousand income tax benefit for the three months ended March 31, 2018.

Overall, the Company anticipates the decrease in the U.S. federal statutory rate resulting from the enactment of the 2017 Tax Reform will have a favorable impact on future U.S. tax expense and operating cash flows. The Company initially recorded the impact of 2017 Tax Reform in the second quarter of Fiscal 2018, inclusive of provisional amounts based on reasonable estimates. However, the final impact of 2017 Tax Reform may differ due to and among other things, changes in interpretations, assumptions made by the Company, the issuance of additional guidance, and actions the Company may take as a result of 2017 Tax Reform. Adjustments, if any, will be made in accordance with SAB 118.

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 March 31, 2018 and June 30, 2017, the Company has total unrecognized tax benefits of \$1.7 million and \$5.9 million, respectively. The decrease was primarily the result of an expiration in the statute of limitations related to several state-related unrecognized tax benefits. As a result of the positions taken during the period, the Company has not recorded any interest and penalties for the period ended March 31, 2018 in the statement of operations and no cumulative interest and penalties have been recorded in the Company's statement of financial position as of March 31, 2018 and June 30, 2017. The Company will recognize interest accrued on unrecognized tax benefits in interest expense and any related penalties in operating expenses.

The Company files income tax returns in the United States federal jurisdiction and various states. The Company's tax returns for Fiscal Year 2014 and prior generally are no longer subject to review as such years generally are closed. The Company's Fiscal Year 2016 federal return is currently under examination by the Internal Revenue Service (IRS). The Company cannot reasonably predict the outcome of the examination at this time.

Note 20. Related Party Transactions

The Company had sales of \$962 thousand and \$823 thousand during the three months ended March 31, 2018 and 2017, respectively, to a generic distributor, Auburn Pharmaceutical Company (Auburn). Sales to Auburn for the nine months ended March 31, 2018 and 2017 were \$3.0 million and \$2.8 million, respectively. Jeffrey Farber, Chairman of the Board, is the owner of Auburn. Accounts receivable includes amounts due from Auburn of \$583 thousand and \$751 thousand at March 31, 2018 and June 30, 2017, respectively.

Table of Contents

The Company also had sales of \$406 thousand and \$617 thousand during the three months ended March 31, 2018 and 2017, respectively, to a generic distributor, KeySource. Sales to KeySource for the nine months ended March 31, 2018 and 2017 were \$1.4 million and \$946 thousand, respectively. Albert Paonessa, a current board member, was appointed the CEO of KeySource in May 2017. Accounts receivable includes amounts due from KeySource of \$340 thousand and \$606 thousand as of March 31, 2018 and June 30, 2017, respectively.

In connection with the termination of the employment of Arthur P. Bedrosian, the Company's former Chief Executive Officer, effective as of December 31, 2017, the Company entered into a separation agreement pursuant to which he will receive certain benefits including, among others, 36 months base salary, a pro-rated Fiscal 2018 cash bonus as well as accelerated vesting of his outstanding equity awards. The total benefits resulted in an approximately \$3.4 million charge to the Company's consolidated statements of operations in the second quarter of Fiscal 2018. On January 20, 2018, the Company also entered into a consulting agreement with Mr. Bedrosian to work on several important projects, primarily involving existing and new partnering efforts to expand and diversify opportunities, including but not limited to spearheading the effort to transition and strengthen the Company's existing contractual relationships with its key partners.

Note 21. 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 37% and 33% of the Company's inventory purchases in the three months ended March 31, 2018 and 2017, respectively. Purchases of finished goods inventory from JSP accounted for 36% and 37% of the Company's inventory purchases in the nine months ended March 31, 2018 and 2017, respectively.

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 requirements. If the Company does not meet the minimum purchase requirements, JSP's sole remedy is to terminate the JSP Distribution Agreement.

Note 22. Subsequent Events

On May 4, 2018, the Company entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") by and between the Company and a subsidiary of Endo International plc ("Endo"), pursuant to which the Company acquired a portfolio of 23 U.S. FDA-approved ANDAs, one ANDA that is pending FDA approval, and manufacturing and other information related to the products (the "Assets"). The purchase of the Assets closed simultaneously with the execution of the Asset Purchase Agreement. Pursuant to the Asset Purchase Agreement, the purchase price for the Assets was \$12 million, \$10 million of which was paid in cash at closing, \$1 million of which is due within five days after the filing of transfer of ownership letters with the FDA for the ANDAs and \$1 million of which is due within five days after the Company first supplies or distributes any products relating to any of the purchased ANDAs to a third party.

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, 2017. All references to Fiscal 2018 or Fiscal Year 2018 shall mean the fiscal year ending June 30, 2018 and all references to Fiscal 2017 or Fiscal Year 2017 shall mean the fiscal year ended June 30, 2017.

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 \$19.0 million in restructuring charges for actions that have been announced or communicated since the 2016 Restructuring Program began. Of this amount, approximately \$10.0 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 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.

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Antibiotic	\$	3,801	\$	4,474
Anti-Psychosis		9,336		14,433
Cardiovascular		18,514		14,815
Central Nervous System		8,395		11,124
Gallstone		3,828		11,157
Gastrointestinal		16,562		19,441
Glaucoma		875		4,868
Migraine		12,888		7,043
Muscle Relaxant		3,299		3,673
Pain Management		6,594		6,085
Respiratory		2,324		4,256
Thyroid Deficiency		69,975		44,999
Urinary		33		2,619
Other		12,376		14,555
Contract manufacturing revenue		5,586		2,178
Net sales		174,386		165,720
Settlement agreement				(4,000)
Total net sales	\$	174,386	\$	161,720

Table of Contents

The increase in net sales was driven by increased volumes of \$25.1 million, partially offset by decreased average selling price of products of \$16.4 million. Volumes were favorably impacted due to a temporary disruption of our competitor's supplies in the Thyroid Deficiency and Migraine medical indications as well as additional sales in the Cardiovascular medical indication related to a distribution agreement entered into during the second quarter of Fiscal 2018. Average selling prices were impacted by competitive pricing pressure across a number of products, product mix and changes within distribution channels. Although the Company has benefited in the past from favorable pricing trends, these trends have reversed. The level of competition in the marketplace is constantly changing and the Company cannot predict with certainty that these trends will continue.

In January 2017, a provision in the Bipartisan Budget Act of 2015 required drug manufacturers to pay additional rebates to state Medicaid programs if the prices of their generic drugs rise at a rate faster than inflation. The provision negatively impacted the Company's net sales by \$9.7 million during the three months ended March 31, 2018, which contributed to the overall decreased average selling price.

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

Medical indication	Sales volume change %	Sales price change %
Antibiotic	%	(15)%
Anti-Psychosis	(29)%	(6)%
Cardiovascular	88%	(63)%
Central Nervous System	(14)%	(11)%
Gallstone	(22)%	(44)%
Gastrointestinal	(2)%	(13)%
Glaucoma	(51)%	(31)%
Migraine	63%	20%
Muscle Relaxant	10%	(20)%
Pain Management	12%	(4)%
Respiratory	(34)%	(11)%
Thyroid Deficiency	36%	20%
Urinary	(36)%	(63)%

Central Nervous System. 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,

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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 and met with the FDA to discuss the results in July 2015.

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. Following the Company's request under the Freedom of Information Act (FOIA) for documents to support its request for a hearing, the FDA granted an extension to submit all data, information and analyses upon which the request for a hearing relies.

In response to the Company's FOIA requests, the FDA provided four sets of documents between April 4, 2017 and October 25, 2017 and, on December 4, 2017, the Company submitted extensive information, data, analyses, and expert reports to the FDA that demonstrate the existence of genuine and substantial issues of fact that necessitate a hearing to prove the therapeutic equivalence of its product. On December 8, 2017, the documents were posted on the public docket. The FDA has not yet made a decision as to whether to grant a hearing to the Company.

Table of Contents

The Company intends to continue working with the FDA to regain the AB rating, and in the meantime, maintain the drug on the U.S. market with a BX rating. However, there can be no assurance as to when or if the Company will regain the AB rating or 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. Such potential contingent payments are set to expire after December 31, 2020.

Pain Management. Cocaine Topical Solution (C-Topical)

In December 2017, a competitor received approval from the FDA to market and sell a Cocaine Hydrochloride topical product. This approval affects the Company's right to market and sell its unapproved Grandfathered C-Topical product. According to FDA guidance, the FDA typically allows the marketing of unapproved products for up to one year following the approval of an NDA for the product. Subsequently, the Company would not be permitted to market and sell its unapproved C-Topical product. For the three and nine month periods ended March 31, 2018, the Company's net sales of C-Topical were \$6.1 million and \$15.9 million, respectively.

The competitor's Cocaine Hydrochloride topical product first appeared in FDA's Orange Book in January 2018, and the Orange Book listing was updated in February 2018 to include New Chemical Entity (NCE) exclusivity. Under the Federal Food Drug and Cosmetic Act, the grant of NCE exclusivity provides that additional applications for approval of the same product under Section 505(b)(2) may not be submitted to the FDA for approval before the expiration of five years from the date of the approval of the first application. Because the Company submitted its application for approval prior to the date of approval of the competitor's Cocaine Hydrochloride topical application, the Company does not believe the NCE exclusivity will apply to the Company's application. The FDA continues to review the Company's application although the Company cannot say for certain when or if the application will be approved.

At this time, the Company cannot predict the ultimate impact that these developments will have on its business and financial performance, including but not limited to any possible price reductions should the competitor commence marketing and selling its C-Topical product in the future, for how long the Company will continue to be permitted to market and sell C-Topical or the possible effect on the Company's pending NDA application.

Gastrointestinal. Polyethylene Glycol 3350 (Glycolax)

On April 2, 2018, the FDA issued a Federal Register notice indicating that it was affirming a preliminary summary judgment decision that the FDA issued in 2014, denying a hearing, and withdrawing all ANDAs for Glycolax, which includes the Company's ANDA for its Glycolax product. The FDA's decision is based on the FDA finding that there are no meaningful differences between Rx PEG 3350 products and OTC PEG 3350 products and, therefore, that the Rx products are misbranded. The FDA ordered the Company's ANDA withdrawn effective May 2, 2018, after which the Company would no longer be permitted to market or sell its Glycolax product. The Company disputes that there are no meaningful differences and disputes that summary judgment was appropriate in light of the factual issues raised by the ANDA holders. On April 9, 2018, the Company, along with three other Glycolax ANDA holders, filed a request for a stay of the FDA order pending appeal of the decision to the DC Circuit Court of Appeals. On April 16, 2018, the FDA granted a stay of its order withdrawing the Company's ANDA through November 2, 2018, after which the Company will no longer be permitted to market or sell its Glycolax product. The Company plans to file an appeal of the FDA decision and will seek to have the appeal decided prior to the November 2, 2018 withdrawal date. For the three and nine month periods ended March 31, 2018, the Company's net sales of Glycolax were \$4.4 million and \$11.7 million, respectively. At this time, the Company is unable to determine the outcome of this matter and cannot predict when or if the Company's product will be removed from the

market.

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 March 31:

(In thousands)		March 31,		March 31,
Customer Distribution Channel		2018		2017
Wholesaler/Distributor	\$	130,268	\$	131,242
Retail Chain		29,785		20,484
Mail-Order Pharmacy		8,747		11,816
Contract manufacturing revenue		5,586		2,178
Net sales		174,386		165,720
Settlement agreement				(4,000)
Total net sales	\$	174,386	\$	161,720

Table of Contents

Net sales to retail chains increased significantly primarily as a result of additional sales of a product in the Cardiovascular medical indication related to a distribution agreement entered into with Aralez Pharmaceuticals (Aralez) in November 2017. In addition, the Company's sales to retail chains continued to benefit from a customer that was unable to obtain supply from a competitor due to a temporary disruption in the competitor's supply chain during the second quarter of Fiscal 2018.

Cost of Sales, including amortization of intangibles. Cost of sales, including amortization of intangibles, for the third quarter of Fiscal 2018 increased 20% to \$107.3 million from \$89.3 million in the same prior-year period. The increase was primarily attributable to higher sales as well as changes in our product sales mix and increased product royalties. Product royalties expense included in cost of sales totaled \$8.7 million for the third quarter of Fiscal Year 2018 and \$4.7 million for the third quarter of Fiscal Year 2017. Amortization expense included in cost of sales totaled \$8.3 million for the third quarter of Fiscal Year 2018 compared to \$7.7 million for the third quarter of Fiscal Year 2017.

Gross Profit. Gross profit for the third quarter of Fiscal 2018 decreased 7% to \$67.1 million or 38% of total net sales. In comparison, gross profit for the third quarter of Fiscal 2017 was \$72.4 million or 45% of total net sales. The decrease in gross profit percentage was primarily attributable to price decreases of certain key products as well as an increase in product royalties related to distribution agreements that were entered into during the third quarter of Fiscal 2018.

Research and Development Expenses. Research and development expenses for the third quarter decreased 67% to \$2.7 million in Fiscal 2018 from \$8.3 million in Fiscal 2017. The decrease was primarily driven by a cancelled order for pre-launch inventory purchased in Fiscal 2017, and to a lesser extent, lower product development expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased 20% to \$14.1 million in the third quarter of Fiscal 2018 compared with \$17.6 million in Fiscal 2017. The decrease was primarily driven by lower incentive compensation-related costs in the third quarter of Fiscal 2018.

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 \$1.3 million as compared to the prior-year period. The decrease was due to the timing of the acquisition of KUPI.

Restructuring Expenses. Restructuring expenses decreased \$147 thousand to \$1.4 million for the third quarter of Fiscal Year 2018 compared to the prior-year period primarily due to higher employee separation costs incurred in connection

with the 2016 Restructuring Program during the three months ended March 31, 2017.

Loss on sale of intangible asset. In the third quarter of Fiscal 2018, the Company sold an intangible asset acquired as part of the KUPI acquisition. In connection with the transaction, the Company recorded a \$15.5 million loss on sale of intangible asset.

Other Income (Loss). Interest expense for the three months ended March 31, 2018 totaled \$22.8 million compared to \$22.4 million for the three months ended March 31, 2017. The weighted average interest rate for the third quarter of Fiscal 2018 and 2017 was 9.7% and 8.3%, respectively. Investment income totaled \$719 thousand in the third quarter of Fiscal 2018 compared with \$1.0 million in the third quarter of Fiscal 2017.

Income Tax. The Company recorded income tax benefit in the third quarter of Fiscal 2018 of \$2.3 million compared to income tax expense of \$7.3 million in the third quarter of Fiscal 2017. The effective tax rate for the three months ended March 31, 2018 was (21.7)%, compared to 33.0% for the three months ended March 31, 2017. The effective tax rate for the three months ended March 31, 2018 was lower compared to the same prior-year period primarily due to the impact for timing items related to the filing of the Company's Fiscal 2017 tax return. The lower blended federal statutory tax rate of approximately 28.0% as compared to 35.0% in the same prior-year period due to 2017 Tax Reform also contributed to a lower effective tax rate. This resulted in an approximately \$763 thousand income tax benefit for the three months ended March 31, 2018. Overall, the Company anticipates the decrease in the U.S. federal statutory rate resulting from the enactment of the 2017 Tax Reform will have a favorable impact on future U.S. tax expense and operating cash flows.

Net Income. For the three months ended March 31, 2018, the Company reported net income attributable to Lannett Company, Inc. of \$12.8 million, or \$0.33 per diluted share. Comparatively, net income attributable to Lannett Company, Inc. in the corresponding prior-year period was \$14.9 million, or \$0.40 per diluted share.

Table of Contents**Results of Operations - Nine months ended March 31, 2018 compared with the nine months ended March 31, 2017**

Total net sales increased to \$513.7 million compared to \$494.2 million in the prior-year period, which included a \$4.0 million reduction for a Settlement Agreement adjustment.

Net sales increased 3% to \$513.7 million for the nine months ended March 31, 2018. The following table identifies the Company's net product sales by medical indication for the nine months ended March 31, 2018 and 2017:

(In thousands) Medical Indication	Nine Months Ended March 31,	
	2018	2017
Antibiotic	\$ 10,701	\$ 13,047
Anti-Psychosis	47,127	47,119
Cardiovascular	39,955	39,484
Central Nervous System	24,137	32,028
Gallstone	15,674	37,465
Gastrointestinal	46,171	56,470
Glaucoma	5,706	15,962
Migraine	43,387	22,066
Muscle Relaxant	10,309	10,208
Pain Management	18,483	20,132
Respiratory	6,200	9,426
Thyroid Deficiency	185,983	130,267
Urinary	5,870	12,413
Other	38,178	36,870
Contract manufacturing revenue	15,771	15,266
Net sales	513,652	498,223
Settlement agreement		(4,000)
Total net sales	\$ 513,652	\$ 494,223

The increase in net sales was driven by increased volumes of \$72.3 million, partially offset by decreased average selling price of products as well as price decreases in several key products of \$56.9 million. Volumes were favorably impacted due to a temporary disruption of our competitor's supplies in the Thyroid Deficiency and Migraine medical indications as well as additional sales in the Cardiovascular medical indication related to a distribution agreement entered into during the second quarter of Fiscal 2018. Average selling prices were impacted by competitive pricing pressure across a number of products, product mix and changes within distribution channels. Although the Company has benefited in the past from favorable pricing trends, these trends have reversed. The level of competition in the marketplace is constantly changing and the Company cannot predict with certainty that these trends will continue.

In January 2017, a provision in the Bipartisan Budget Act of 2015 required drug manufacturers to pay additional rebates to state Medicaid programs if the prices of their generic drugs rise at a rate faster than inflation. The provision negatively impacted the Company's net sales by \$22.2 million during the nine months ended March 31, 2018, which contributed to the overall decreased average selling price.

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

Medical indication	Sales volume change %	Sales price change %
Antibiotic	(4)%	(14)%
Anti-Psychosis	(6)%	6%
Cardiovascular	54%	(53)%
Central Nervous System	(12)%	(13)%
Gallstone	(21)%	(37)%
Gastrointestinal	5%	(23)%
Glaucoma	(20)%	(44)%
Migraine	97%	%
Muscle Relaxant	64%	(63)%
Pain Management	(6)%	(2)%
Respiratory	(14)%	(20)%
Thyroid Deficiency	29%	14%
Urinary	(9)%	(44)%

Table of Contents

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 nine months ended March 31, 2018 and 2017:

(In thousands)	March 31, 2018	March 31, 2017
Customer Distribution Channel		
Wholesaler/Distributor	\$ 377,833	\$ 385,751
Retail Chain	88,786	60,035
Mail-Order Pharmacy	31,262	37,171
Contract manufacturing revenue	15,771	15,266
Net sales	513,652	498,223
Settlement agreement		(4,000)
Total net sales	\$ 513,652	\$ 494,223

Net sales to retail chains increased significantly as a result of additional sales to a customer that was unable to obtain supply from a competitor due to a temporary disruption in the competitor's supply chain, and to a lesser extent, additional sales of a product in the Cardiovascular medical indication related to a distribution agreement entered into with Aralez Pharmaceuticals (Aralez) in November 2017.

Cost of Sales, including amortization of intangibles. Cost of sales, including amortization of intangibles for the first nine months of Fiscal 2018 increased 16% to \$291.5 million from \$251.9 million in the same prior-year period. The increase was primarily attributable to higher sales as well as changes in our product sales mix and increased product royalties. Product royalties expense included in cost of sales totaled \$22.7 million for the first nine months of Fiscal Year 2018 and \$14.6 million for the first nine months of Fiscal Year 2017. Amortization expense included in cost of sales totaled \$24.0 million for the first nine months of Fiscal Year 2018 and \$24.4 million for the first nine months of Fiscal Year 2017.

Gross Profit. Gross profit for the first nine months of Fiscal 2018 decreased 8% to \$222.2 million or 43% of total net sales. In comparison, gross profit for the first nine months of Fiscal 2017 was \$242.3 million or 49% of total net sales. The decrease in gross profit percentage was primarily attributable to lower average selling prices of certain key products as well as additional product royalties related to distribution agreements that were entered into during the third quarter of Fiscal 2018.

Research and Development Expenses. Research and development expenses for the first nine months decreased 32% to \$20.9 million in Fiscal 2018 from \$30.7 million in Fiscal 2017. The decrease was primarily due to lower product development expenses as well as decreased spend related to the C-Topical clinical trials. Research and development expenses for the first nine months also decreased due to a cancelled order for pre-launch inventory purchased in Fiscal 2017.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 8% to \$61.6 million in the first nine months of Fiscal 2018 compared with \$57.0 million in Fiscal 2017. The increase was primarily driven

by approximately \$3.4 million related to separation benefits for the former chief executive officer.

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 \$3.6 million compared to the prior-year period. The decrease was due to the timing of the acquisition of KUPI.

Restructuring Expenses. Restructuring expenses decreased \$2.3 million compared to the prior-year period primarily due to higher employee separation costs incurred in connection with the 2016 Restructuring Program during the nine months ended March 31, 2017.

Loss on sale of intangible asset. In the third quarter of Fiscal 2018, the Company sold an intangible asset acquired as part of the KUPI acquisition. In connection with the transaction, the Company recorded a \$15.5 million loss on sale of intangible asset.

Other Income (Loss). Interest expense in the first nine months of Fiscal 2018 totaled \$64.4 million compared to \$68.7 million in Fiscal 2017. The weighted average interest rate for the first nine months of Fiscal 2018 and 2017 was 8.8% and 7.9%, respectively. Investment income in the first nine months of Fiscal 2018 totaled \$4.2 million compared with investment income of \$3.1 million in Fiscal 2017.

Table of Contents

Income Tax. The Company recorded income tax expense in the first nine months of Fiscal 2018 of \$23.3 million compared to an income tax benefit of \$2.0 million in the first nine months of Fiscal 2017. The effective tax rate for the nine months ended March 31, 2018 was 36.8% compared to 24.2% for the nine months ended March 31, 2017. The effective tax rate for the nine months ended March 31, 2018 was higher compared to the same prior-year period primarily due to 2017 Tax Reform. Among numerous provisions included in the new law was the reduction of the statutory corporate federal income tax rate from 35% to 21%. The Company applied the newly enacted corporate federal income tax rate of 21% resulting in an approximately \$8.1 million revaluation of the Company's net long term deferred tax assets. The increase in the effective tax rate as a result of the revaluation was partially offset by a lower blended federal statutory tax rate of approximately 28.0% as compared to 35.0% in the same prior-year period. This resulted in an approximately \$4.6 million income tax benefit for the nine months ended March 31, 2018.

Net Income (Loss). For the nine months ended March 31, 2018, the Company reported net income attributable to Lannett Company, Inc. of \$40.0 million, or \$1.05 per diluted share. Comparatively, net loss attributable to Lannett Company, Inc. in the corresponding prior-year period was \$6.3 million, or \$0.17 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 March 31, 2018, working capital was \$318.1 million as compared to \$302.6 million at June 30, 2017, an increase of \$15.5 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.

Net cash provided by operating activities of \$103.4 million for the nine months ended March 31, 2018 reflected net income of \$40.0 million, adjustments for non-cash items of \$112.1 million, as well as cash used by changes in operating assets and liabilities of \$48.7 million. In comparison, net cash provided by operating activities of \$120.5 million for the nine months ended March 31, 2017 reflected net loss of \$6.3 million, adjustments for non-cash items of \$143.0 million, as well as cash used by changes in operating assets and liabilities of \$16.2 million.

Significant changes in operating assets and liabilities from June 30, 2017 to March 31, 2018 were comprised of:

- An increase in accounts receivable of \$34.7 million mainly due to increased sales as well as the timing of collections during the quarter ended March 31, 2018 compared to the quarter ended June 30, 2017. The Company's days sales outstanding (DSO) at March 31, 2018, based on gross sales for the nine months ended March 31, 2018 and gross accounts receivable at March 31, 2018 was 78 days. The level of DSO at March 31, 2018 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 other assets totaling \$8.0 million primarily due to prepaid inventory in connection with a distribution agreement entered into during the second quarter of Fiscal 2018.
- An increase in inventories totaling \$10.7 million primarily due to the timing of customer order fulfillment.
- An increase in accrued payroll and payroll-related costs of \$4.5 million primarily due to the timing of payroll payments as well as approximately \$2.6 million related to severance benefits for the former chief executive officer.

Significant changes in operating assets and liabilities from June 30, 2016 to March 31, 2017 were comprised of:

- An increase in accounts receivable of \$9.5 million mainly due to the timing of collections during the quarter ended March 31, 2017. The Company's days sales outstanding (DSO) at March 31, 2017, based on gross sales for the nine months ended March 31, 2017 and gross accounts receivable at March 31, 2017 was 73 days. The level of DSO at March 31, 2017 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 \$8.9 million primarily due to a decision to increase our inventory supply of certain key products in order to meet customer demands.
- An increase in prepaid income taxes totaling \$9.9 million mainly due to estimated tax payments made during Fiscal 2017.
- An increase in rebates payable of \$12.8 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 of \$11.6 million due to the timing of payments.

Net cash used in investing activities of \$36.9 million for the nine months ended March 31, 2018 is mainly the result of purchases of investment securities of \$62.6 million, purchases of property, plant and equipment of \$41.1 million, loan advances to a variable interest entity of \$10.0 million and the purchases of intangible assets of \$7.0 million, partially offset by proceeds from the sale of investment securities of \$83.8 million.

Table of Contents

Net cash used in investing activities of \$38.0 million for the nine months ended March 31, 2017 is mainly the result of purchases of investment securities of \$50.5 million and purchases of property, plant and equipment of \$32.1 million, partially offset by proceeds from the sale of investment securities of \$44.6 million.

Net cash used in financing activities of \$70.0 million for the nine months ended March 31, 2018 was primarily due to debt repayments of \$69.0 million and purchases of treasury stock totaling \$4.6 million, partially offset by proceeds from issuance of stock pursuant to stock compensation plans of \$3.6 million. Net cash used in financing activities of \$175.3 million for the nine months ended March 31, 2017 was primarily due to debt repayments of \$139.9 million, payment of contingent consideration to UCB of \$35.0 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 \$2.2 million and excess tax benefits on share-based compensation awards of \$725 thousand.

Credit Facility and Other Indebtedness

The Company has previously entered into and may enter into 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 March 31, 2018 are as follows:

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 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.

Refer to the Company's Form 10-K for the fiscal year ended June 30, 2017 for further details on the Amended Senior Secured Credit Facility.

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 2018 and thereafter. If the Company does not meet the minimum purchase requirements, JSP's sole remedy is to terminate the agreement.

Cody Expansion

In January 2017, the Company announced a \$50 million expansion plan in conjunction with Forward Cody to expand operations in Cody, WY. In the third quarter of Fiscal 2018, the Company reviewed and recalibrated the timing of various investments related to its growth strategy. As part of the Company's initiatives to focus on nearer-term opportunities to grow the business, the Company has decided to temporarily suspend the Cody Expansion project.

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.

Table of Contents

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.

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

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accounts receivable or included as rebates payable. The reserves presented as a reduction of accounts receivable totaled \$218.5 million and \$175.8 million at March 31, 2018 and June 30, 2017, respectively. Rebates payable at March 31, 2018 and June 30, 2017 were \$41.3 million and \$44.6 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-related reserve for the nine months ended March 31, 2018 and 2017:

Reserve Category (In thousands)	Chargebacks	Rebates	Returns	Other	Total
Balance at June 30, 2017	\$ 79,537	\$ 87,616	\$ 42,135	\$ 11,096	\$ 220,384
Current period provision	797,964	228,100	21,661	52,329	1,100,054
Credits issued during the period	(764,055)	(239,665)	(16,543)	(40,399)	(1,060,662)
Balance at March 31, 2018	\$ 113,446	\$ 76,051	\$ 47,253	\$ 23,026	\$ 259,776

Table of Contents

Reserve Category (In thousands)	Chargebacks		Rebates		Returns		Other		Total	
Balance at June 30, 2016	\$	86,495	\$	54,084	\$	40,593	\$	16,851	\$	198,023
Measurement-period adjustments				8,329		5,955				14,284
Current period provision		663,962		218,922		21,361		41,953		946,198
Credits issued during the period		(650,069)		(201,511)		(25,622)		(46,416)		(923,618)
Balance at March 31, 2017	\$	100,388	\$	79,824	\$	42,287	\$	12,388	\$	234,887

For the three months ending March 31, 2018 and 2017, as a percentage of gross sales the provision for chargebacks was 54.3% and 48.9%, the provision for rebates was 12.1% and 15.0%, the provision for returns was 1.2% and 1.3%, and the provision for other adjustments was 4.0% and 2.5%, respectively.

For the nine months ending March 31, 2018 and 2017, as a percentage of gross sales the provision for chargebacks was 49.9% and 46.5%, the provision for rebates was 14.3% and 15.3%, the provision for returns was 1.4% and 1.5%, and the provision for other adjustments was 3.3% and 2.9%, respectively.

The increase in total reserves from June 30, 2017 to March 31, 2018 was mainly due to an increase in the chargebacks reserve, which was the result of a higher chargeback rate associated with the distributed product from Aralez. The chargebacks reserve also increased due to higher inventory levels on-hand at the Company's wholesaler customers in March 31, 2018 as compared to June 30, 2017. In addition, a change in the Company's billing practices required by one of our major wholesaler customers resulted in a shift from rebates to chargebacks with no significant change to the total reserve balance. The activity in the Other category includes shelf-stock, shipping and other sales adjustments including prompt payment discounts. The increase in this reserve category for the nine months ended March 31, 2018 as compared to the prior-year period was a result of sales adjustments related to the inability to fulfill certain customer orders. 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.

Refer to the Company's Form 10-K for the fiscal year ended June 30, 2017 for a description of our remaining Critical Accounting Policies.

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 March 31, 2018, each 1/8% increase in interest rates would yield \$1.1 million of incremental annual interest expense.

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

During the third quarter of Fiscal 2017, the Company completed the carve-out of data and software systems supporting the operations of KUPI from the hosted environment of UCB. The integration of the Company's entities into a single consolidated system is planned in phases and is expected to be completed in Fiscal 2018. As such, internal controls have and will continue to change in various functional areas within the Company. However, management has taken steps to ensure that any changes to the design and implementation of internal controls continue to function appropriately. There have been no other changes in Lannett's internal control over financial reporting during the nine months ended March 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information pertaining to legal proceedings can be found in Note 12. 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, 2017 includes a detailed description of its risk factors.

In addition to the information set forth in this Form 10-Q, you should carefully consider the risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2017.

The recent enactment of State laws affecting the pricing of our products could have the effect of reducing our profitability.

Between 2016 and 2018, several state legislatures have enacted laws regulating the pricing of various types of pharmaceutical products, including generic pharmaceutical products. These laws vary in applicability and scope, and generally require manufacturers to notify various state agencies of price increases over a given threshold for a given period of time and to include a justification for any price increases. At least one state law (subsequently struck by the court) authorized the state attorney general to seek civil penalties and disgorgement in the event a price increase is deemed unconscionable. To the extent these laws apply to our products,

Table of Contents

they could limit the prices which the company may be to charge for its products and reduce the company's profitability and could have a material adverse effect on our financial condition, results of operations and growth prospects.

Other manufacturers and distributors of pain management products have had complaints filed against and investigations commenced them, and if similar actions are taken against us it could reduce our revenue and future profitability.

During the past few years, a number of complaints have been filed with respect to sales and distribution of various types of pain management medications against various pharmaceutical companies (not including Lannett), by a number of cities, counties and states across the country alleging among other things that such companies failed to develop and implement systems sufficient to identify suspicious orders of such products and prevent the diversion of such products to individuals who used them for other than legitimate medical purposes. The complaints generally contend that the defendants allegedly engaged in improper marketing of pain management products, and seek a variety of remedies, including restitution, civil penalties, disgorgement of profits, treble damages, attorneys' fees and injunctive relief. In addition, a number of State Attorneys General, including a coordinated multistate effort, have initiated investigations into sales and marketing practices of various pharmaceutical companies (not including Lannett) with respect to such pain management products. If any similar investigations or claims are commenced against us, it could result in reputational harm and reduced market acceptance and demand for our products, could harm our ability to market our products in the future, could cause us to incur significant expense, could cause our senior management to be distracted from execution of our business strategy, and could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Guidelines and recommendations published by various organizations can reduce the use of our pain management products.

Government agencies promulgate regulations and guidelines directly applicable to us and to our products. In addition, professional societies, practice management groups, private health and science foundations and organizations from time to time may also publish guidelines or recommendations to the healthcare and patient communities. Recommendations of government agencies or these other groups or organizations may relate to such matters as usage, dosage, route of administration and use of concomitant therapies. For example, the Centers for Disease Control and Prevention has issued guidelines about the use of pain management products for chronic pain, the FDA has issued an Opioid Action Plan and in 2017 President Trump signed an executive order establishing the President's Commission on Combatting Drug Addiction. Recommendations or guidelines suggesting the reduced use of our products or the use of competitive or alternative products as the standard of care to be followed by patients and healthcare providers could result in decreased use of our products, and could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Table of Contents**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.

Exhibit Index

31.1	<u>Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed Herewith
31.2	<u>Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed Herewith
32	<u>Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	Filed Herewith
101.INS	XBRL Instance Document	Filed Herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed Herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed Herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed Herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed Herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	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: May 8, 2018

By: */s/ Timothy C. Crew*
Timothy C. Crew
Chief Executive Officer

Dated: May 8, 2018

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

Dated: May 8, 2018

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