LANNETT CO INC
Form 10-Q
November 06, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2014

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

FOR THE TRANSITION PERIOD FROM TO

Commission File No. 001-31298

LANNETT COMPANY, INC.

(Exact Name of Registrant as Specified in its Charter)

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

9000 State Road

Philadelphia, PA 19136

(215) 333-9000

(Address of principal executive offices and telephone number)

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

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

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

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

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

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

Class	**Outstanding as of October 31, 2014**
Common stock, par value $0.001 per share	35,757,847

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LANNETT COMPANY, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	(Unaudited) September 30, 2014	June 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 137,395**	$ 105,587
Investment securities	**14,929**	40,693
Accounts receivable, net	**75,835**	61,325
Inventories, net	**44,070**	44,844
Deferred tax assets	**12,220**	11,265
Other current assets	**3,342**	1,833
Total current assets	**287,791**	265,547
Property, plant and equipment, net	**69,736**	61,704
Intangible assets, net	**1,207**	927
Deferred tax assets	**14,949**	14,234
Other assets	**340**	361
TOTAL ASSETS	**$ 374,023**	$ 342,773
LIABILITIES		
Current liabilities:		
Accounts payable	**$ 13,959**	$ 20,982
Accrued expenses	**2,578**	3,901
Accrued payroll and payroll-related expenses	**3,863**	12,860
Rebates payable	**6,152**	4,558
Income taxes payable	**13,735**	4,569
Current portion of long-term debt	**131**	129
Total current liabilities	**40,418**	46,999
Long-term debt, less current portion	**975**	1,009
TOTAL LIABILITIES	**41,393**	48,008
Commitments and Contingencies (Note 13)		
STOCKHOLDERS EQUITY		
Common stock ($0.001 par value, 100,000,000 shares authorized; 36,171,478 and 36,088,272 shares issued; 35,654,486 and 35,571,280 shares outstanding at September 30, 2014 and June 30, 2014, respectively)	**36**	36
Additional paid-in capital	**219,708**	216,793
Retained earnings	**118,586**	83,654
Accumulated other comprehensive loss	**(54)**	(54)
Treasury stock (516,992 shares at September 30, 2014 and June 30, 2014)	**(5,959)**	(5,959)
Total Lannett Company, Inc. stockholders equity	**332,317**	294,470

Noncontrolling Interest		**313**		295
Total stockholders equity		**332,630**		294,765
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	**$**	**374,023**	$	342,773

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

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LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(In thousands, except share and per share data)

	Three Months Ended September 30,	
	2014	**2013**
Net sales	**$ 93,387**	$ 45,829
Cost of sales	**21,820**	24,423
JSP contract renewal cost		20,100
Gross profit	**71,567**	1,306
Operating expenses:		
Research and development	**6,363**	4,745
Selling, general, and administrative	**10,553**	7,179
Total operating expenses	**16,916**	11,924
Operating income (loss)	**54,651**	(10,618)
Other income (expense):		
Gain (loss) on sale of assets	**20**	(62)
Gain on investment securities	**15**	463
Interest and dividend income	**102**	46
Interest expense	**(38)**	(58)
Total other income	**99**	389
Income (loss) before income tax	**54,750**	(10,229)
Income tax expense (benefit)	**19,800**	(4,242)
Net income (loss)	**34,950**	(5,987)
Less: Net income attributable to noncontrolling interest	**18**	8
Net income (loss) attributable to Lannett Company, Inc.	**$ 34,932**	$ (5,995)
Earnings (loss) per common share attributable to Lannett Company, Inc.:		
Basic	**$ 0.98**	$ (0.20)
Diluted	**$ 0.94**	$ (0.20)
Weighted average common shares outstanding:		
Basic	**35,597,931**	29,586,237
Diluted	**36,972,646**	29,586,237

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

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LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

(In thousands)

	Three Months Ended September 30,	
	2014	**2013**
Net income (loss)	**$ 34,950**	$ (5,987)
Other comprehensive income (loss), before tax:		
Foreign currency translation gain (loss)		(1)
Total other comprehensive income (loss), before tax		(1)
Income tax related to items of other comprehensive income		
Total other comprehensive income (loss), net of tax		(1)
Comprehensive income (loss)	**34,950**	(5,988)
Less: Total comprehensive income attributable to noncontrolling interest	**18**	8
Comprehensive income (loss) attributable to Lannett Company, Inc.	**$ 34,932**	$ (5,996)

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

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LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(UNAUDITED)

(In thousands)

	Stockholders Equity Attributable to Lannett Company Inc.								
	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholders Equity Attributable to Lannett Co., Inc.	Noncontrolling Interest	Total Stockholders Equity
	Shares Issued	Amount							
Balance, July 1, 2014	36,088	$ 36	$ 216,793	$ 83,654	$ (54)	$ (5,959)	$ 294,470	$ 295	$ 294,765
Shares issued in connection with share-based compensation plans	83		773				773		773
Share-based compensation			1,647				1,647		1,647
Excess tax benefits on share-based compensation awards			495				495		495
Net income				34,932			34,932	18	34,950
Balance, September 30, 2014	**36,171**	**$ 36**	**$ 219,708**	**$ 118,586**	**$ (54)**	**$ (5,959)**	**$ 332,317**	**$ 313**	**$ 332,630**

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

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LANNETT COMPANY, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(In thousands)

	Three Months Ended September 30,	
	2014	**2013**
OPERATING ACTIVITIES:		
Net income (loss)	**$ 34,950**	$ (5,987)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	**1,306**	1,573
Deferred income tax benefit	**(1,670)**	(3,028)
Share-based compensation	**1,647**	897
Excess tax benefits on share-based compensation awards	**(495)**	(407)
Loss (gain) on sale of assets	**(20)**	62
Gain on investment securities	**(15)**	(463)
JSP contract renewal cost		20,100
Other noncash expenses	**21**	4
Changes in assets and liabilities which provided (used) cash:		
Trade accounts receivable	**(14,510)**	(3,336)
Inventories	**774**	(1,993)
Income taxes payable/receivable	**9,661**	(2,914)
Prepaid expenses and other assets	**(1,509)**	(854)
Rebates payable	**1,594**	596
Accounts payable	**(7,023)**	(6,032)
Accrued expenses	**(1,323)**	643
Accrued payroll and payroll-related expenses	**(8,997)**	(3,856)
Net cash provided by (used in) operating activities	**14,391**	(4,995)
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	**(9,374)**	(2,018)
Proceeds from sale of property, plant and equipment	**76**	40
Purchases of intangible assets	**(300)**	
Proceeds from sale of investment securities	**34,213**	4,584
Purchase of investment securities	**(8,434)**	(5,733)
Net cash provided by (used in) investing activities	**16,181**	(3,127)
FINANCING ACTIVITIES:		
Repayments of debt	**(32)**	(127)
Proceeds from issuance of stock	**773**	881
Excess tax benefits on share-based compensation awards	**495**	407
Net cash provided by financing activities	**1,236**	1,161
Effect on cash and cash equivalents of changes in foreign exchange rates		(1)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**31,808**	(6,962)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	**105,587**	42,689
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$ 137,395**	$ 35,727
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	**$ 25**	$ 57

Income taxes paid	**$**	**11,809**	$	1,700

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

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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 U.S. generally accepted accounting principles (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 months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2015. You should read these unaudited financial statements 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 Financial Statements, including the Notes to the Financial Statements, included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

Note 2. The Business And Nature of Operations

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

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania and Cody, Wyoming. Customers of the Company s pharmaceutical products 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

Principles of consolidation

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

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, 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.

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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 comprehensive income (loss). Gains and losses resulting from transactions denominated in foreign currencies are recognized in the Consolidated Statements of Operations under Other income (expense). Amounts recorded due to foreign currency fluctuations are immaterial to the consolidated financial statements.

Cash and cash equivalents

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

Investment securities

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

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 obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they are determined to be uncollectible.

Inventories

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

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the assets estimated useful lives. Depreciation expense for the three months ended September 30, 2014 and 2013 was $1.3 million and $1.1 million, respectively.

Intangible Assets

Intangible assets are stated at cost less accumulated amortization. Amortization 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. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Costs to renew or extend the term of a recognized intangible asset are expensed as incurred. The Company has several indefinite-lived intangible assets related to product Abbreviated New Drug Applications (ANDAs), valued at $449 thousand. Amortization on these indefinite-lived intangibles will begin at such time as the Company begins shipping the products and determines a finite useful life.

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Segment Information

The Company operates 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 months ended September 30, 2014 and 2013:

(In thousands)	Three Months Ended September 30,	
Medical Indication	**2014**	**2013**
Antibiotic	$ 3,003	$ 3,375
Cardiovascular	18,939	4,524
Gallstone	11,761	1,366
Glaucoma	4,691	1,455
Gout	2,299	2,053
Migraine	5,795	2,715
Obesity	915	1,131
Pain Management	6,655	5,218
Thyroid Deficiency	33,346	20,027
Other	5,983	3,965
Total	$ 93,387	$ 45,829

Customer, Supplier and Product Concentration

The following table presents the percentage of total net sales, for the three months ended September 30, 2014 and 2013, for certain of the Company s products, defined as products containing the same active ingredient or combination of ingredients, which accounted for at least 10% of net sales in any of those periods:

	2014	**2013**
Product 1	36%	44%
Product 2	19%	6%
Product 3	13%	3%

The following table presents the percentage of total net sales, for the three months ended September 30, 2014 and 2013, for certain of the Company s customers which accounted for at least 10% of net sales in any of those periods:

	2014	**2013**
Customer A	31%	14%
Customer B	9%	11%
Customer C	0%	16%

As shown above, customer concentration was impacted by the strategic partnership between Amerisource Bergen and Walgreens, whereby Amerisource Bergen began product distribution on behalf of Walgreens in third quarter of Fiscal Year 2014.

At September 30, 2014 and June 30, 2014, four customers accounted for 83% and 67% of the Company s net accounts receivable balance, respectively. Credit terms are offered to customers based on evaluations of the customers financial condition, and collateral is generally not required.

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 67% of the Company s inventory purchases during the three months ended September 30, 2014 and 2013. See Note 20 Material Contracts with Suppliers for more information.

Revenue Recognition

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

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Net Sales Adjustments

When revenue is recognized a simultaneous adjustment to gross sales is made for chargebacks, rebates, returns, promotional adjustments, and other potential adjustments. These provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers, and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable, depending on the nature of the reserve. The reserves, presented as a reduction of accounts receivable, totaled $57.4 million and $51.9 million at September 30, 2014 and June 30, 2014, respectively. Rebates payable at September 30, 2014 and June 30, 2014 included $6.2 million and $4.6 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

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

Research and Development

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

Valuation of Long-Lived Assets

The Company s long-lived assets primarily consist of property, plant and equipment as well as definite-lived intangible assets. Long-lived 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 first step in the impairment test is to compare the asset s carrying value 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. 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.

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 line item.

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

Income Taxes

The Company uses the asset and 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

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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 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 standards issued by the Financial Accounting Standards Board (FASB) also provide guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. 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.

Earnings Per Common Share

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

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 revenues, expenses, gains and losses that are included in comprehensive income (loss), but excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity.

Recent Accounting Pronouncements

In May 2014, the FASB issued authoritative guidance on revenue recognition. 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, 2016. Early application is not permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

Note 4. Accounts Receivable

Accounts receivable consisted of the following components at September 30, 2014 and June 30, 2014:

(In thousands)	September 30, 2014	June 30, 2014
Gross accounts receivable	$ 133,342	$ 113,420
Less Chargebacks reserve	(32,778)	(30,320)
Less Rebates reserve	(10,963)	(10,532)
Less Returns reserve	(11,962)	(9,341)
Less Other deductions	(1,709)	(1,787)
Less Allowance for doubtful accounts	(95)	(115)
Accounts receivable, net	$ 75,835	$ 61,325

For the three months ended September 30, 2014, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of $77.9 million, $18.6 million, $4.1 million, and $9.0 million, respectively. For the three months ended September 30, 2013, the Company recorded a provision for chargebacks, rebates (including rebates presented as rebates payable), returns, and other deductions of $17.7 million, $7.5 million, $1.2 million, and $3.9 million, respectively.

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Note 5. Inventories

Inventories, net of allowances, at September 30, 2014 and June 30, 2014 consisted of the following:

(In thousands)	September 30, 2014	June 30, 2014
Raw Materials	$ 19,039	$ 19,767
Work-in-process	5,852	5,440
Finished Goods	17,192	17,592
Packaging Supplies	1,987	2,045
Total	$ 44,070	$ 44,844

The reserve for excess and obsolete inventory was $3.5 million and $2.4 million at September 30, 2014 and June 30, 2014, respectively.

Note 6. Property, Plant and Equipment

Property, plant and equipment at September 30, 2014 and June 30, 2014 consisted of the following:

(In thousands)	Useful Lives	September 30, 2014	June 30, 2014
Land		$ 4,641	$ 4,641
Building and improvements	10 - 39 years	43,362	42,013
Machinery and equipment	5 - 10 years	39,918	37,678
Furniture and fixtures	5 - 7 years	1,451	1,416
Construction in progress		16,761	11,454
Property, plant and equipment, gross		106,133	97,202
Less accumulated depreciation		(36,397)	(35,498)
Property, plant and equipment, net		$ 69,736	$ 61,704

During the three months ended September 30, 2014 and 2013 the Company had no impairment charges. Property, plant and equipment, net included amounts held in foreign countries in the amount of $1.5 million and $1.1 million at September 30, 2014 and June 30, 2014, respectively.

Note 7. 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.

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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 September 30, 2014 and June 30, 2014, were as follows:

	September 30, 2014			
(In thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Equity securities	$ 14,929	$	$	$ 14,929
Total Investment Securities	$ 14,929	$	$	$ 14,929

	June 30, 2014			
(In thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Equity securities	$ 15,193	$	$	$ 15,193
Certificates of Deposit	25,500			25,500
Total Investment Securities	$ 40,693	$	$	$ 40,693

Note 8. Investment Securities

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

The Company had a net gain on investment securities of $15 thousand during the three months ended September 30, 2014, which included an unrealized loss related to securities still held at September 30, 2014 of $81 thousand.

The Company had a net gain on investment securities of $463 thousand during the three months ended September 30, 2013, which included an unrealized gain related to securities still held at September 30, 2013 of $367 thousand.

Note 9. Intangible Assets

Intangible assets, net as of September 30, 2014 and June 30, 2014, consisted of the following:

(In thousands)	Gross Carrying Amount		Accumulated Amortization		Intangible Assets, Net	
	September 30, 2014	June 30, 2014	September 30, 2014	June 30, 2014	September 30, 2014	June 30, 2014
Cody Labs Import License	$ 582	$ 582	$ (241)	$ (232)	$ 341	$ 350
Morphine Sulfate Oral Solution NDA	202	202	(68)	(65)	134	137
Other ANDA Product Rights	900	600	(168)	(160)	732	440
	$ 1,684	$ 1,384	$ (477)	$ (457)	$ 1,207	$ 927

For the three months ended September 30, 2014 and 2013, the Company incurred amortization expense of approximately $20 thousand and $470 thousand, respectively. There were no impairments related to intangible assets during each of the three months ended September 30, 2014 and 2013.

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Future annual amortization expense consisted of the following as of September 30, 2014:

(In thousands) Fiscal Year Ending June 30,	Annual Amortization Expense
2015	$ 61
2016	82
2017	82
2018	82
2019	79
Thereafter	372
	$ 758

The amounts above do not include the product line covered by the ANDA purchased in August 2009 for $149 thousand and ANDAs purchased in September 2014 for $300 thousand. Amortization on these assets will begin when the Company begins shipping the product.

Note 10. Bank Line of Credit

In December 2013, the Company entered into a credit agreement (the Citibank Line of Credit) with Citibank, N.A., as administrative agent, and another financial institution. The Citibank Line of Credit provides for a revolving loan commitment in the amount of up to $50.0 million. Any loans under the Citibank Line of Credit will bear interest at either a Eurodollar Rate or a Base Rate plus a specified margin. The Company is also required to pay a commitment fee on any undrawn commitments under the Citibank Line of Credit ranging from 0.2% - 0.3% per annum according to the average daily balance of borrowings under the agreement. The Citibank Line of Credit is collateralized by substantially all of the Company s assets. In connection with securing the Citibank Line of Credit, the Company repaid substantially all of its outstanding debt. See Note 11 Long-Term Debt for more information. As of September 30, 2014 and June 30, 2014, the Company had $50.0 million available under the Citibank Line of Credit.

The Citibank Line of Credit contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for credit facilities of this type. As of September 30, 2014 and June 30, 2014, the Company was in compliance with all financial covenants.

Note 11. Long-Term Debt

Long-term debt consisted of the following:

(In thousands)	September 30, 2014	June 30, 2014
First National Bank of Cody mortgage	$ 1,106	$ 1,138
Less current portion	131	129

Long-term debt	$ 975	$ 1,009

Current Portion of Long-term Debt:

(In thousands)	September 30, 2014	June 30, 2014
First National Bank of Cody mortgage	$ 131	$ 129

The Company is the primary beneficiary to a VIE called Realty. The VIE owns land and a building which is leased to Cody Labs. A mortgage loan with First National Bank of Cody has been consolidated in the Company s financial statements, along with the related land and building. The mortgage requires monthly principal and interest payments of $15 thousand. As of September 30, 2014 and June 30, 2014, the effective interest rate was 4.5%. The mortgage is collateralized by the land and building with a net book value of $1.5 million.

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Long-term debt amounts due for the twelve month periods ending September 30 were as follows:

(In thousands)	Amounts Payable to Institutions
2015	$ 131
2016	137
2017	143
2018	149
2019	156
Thereafter	390
Total	$ 1,106

Note 12. Legal and Regulatory Matters

Richard Asherman

On April 16, 2013, Richard Asherman (Asherman), the former President of and a member in Realty, filed a complaint (Complaint) in Wyoming state court against the Company and Cody Labs. At the same time, he also filed an application for a temporary restraining order to enjoin certain operations at Cody Labs, claiming, among other things, that Cody Labs is in violation of certain zoning laws and that Cody Labs is required to increase the level of its property insurance and to secure performance bonds for work being performed at Cody Labs. Mr. Asherman claims Cody Labs is in breach of his employment agreement and is required to pay him severance under his employment agreement, including 18 months of base salary, vesting of unvested stock options and continuation of benefits. The Company estimates that the aggregate value of the claimed severance benefits is approximately $350 thousand to $400 thousand, plus the value of any stock options. Mr. Asherman also asserts that the Company is in breach of the Realty Operating Agreement and, among other requested remedies, he seeks to have the Company (i) pay him 50% of the value of 1.66 acres of land that Realty previously agreed to donate to an economic development entity associated with the City of Cody, Wyoming, which contemplated transaction has since been avoided and cancelled. Although Mr. Asherman originally sought to require that Lannett acquire his interest in Realty for an unspecified price and/or to dissolve Realty, those claims were recently dismissed.

The Company strongly disputes the claims in the Amended Complaint, including that the Company is required to acquire Mr. Asherman s interest in Realty. If Mr. Asherman were successful on his claim for breach of his employment agreement, he would be entitled to his contractual severance 18 months salary plus the vesting of certain stock options and continuation of benefits. The amount the Company would be required to pay to Mr. Asherman if he were successful in compelling the buyout of his interest in Realty is dependent upon the value of the real property owned by Realty. If a buyout were required, Realty would become wholly owned by the Company. At this time the Company is unable to reasonably estimate a range or aggregate dollar amount of Mr. Asherman s claims or of any potential loss, if any, to the Company.The Company does not believe that the ultimate resolution of the matter will have a significant impact on the Company s financial position or results of operations.

Connecticut Attorney General Inquiry

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

Federal Investigation into the Generic Pharmaceutical Industry

On November 3, 2014, the Senior Vice President of Sales and Marketing of the Company was served with a grand jury subpoena relating to a federal investigation of the generic pharmaceutical industry into possible violations of the Sherman Act. The subpoena requests corporate documents of the Company relating to communications or correspondence with competitors regarding the sale of generic prescription medications, but is not specifically directed to any particular product and is not limited to any particular time period. The Company maintains that it has acted in compliance with all applicable laws and regulations and intends to cooperate with the federal investigation.

Class Action - David Schaefer

On August 27, 2014, David Schaefer, as an alleged class representative, filed a class action complaint in the United States District Court, Eastern District of Pennsylvania (14-cv-05008) against the Company and certain of its officers, alleging violations of federal securities laws arising out of statements about the Company made in its securities filings during the period of September 10, 2013 through July 16, 2014. The complaint alleges that the statements were false and misleading because the defendants allegedly knew at the time the statements were made that the Company was in violation of Connecticut antitrust laws relating to its sale of digoxin. Mr. Schaefer s complaint was voluntarily dismissed in September 2014.

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Patent Infringement (Paragraph IV Certification)

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

Zomig®

The Company filed with the Food and Drug Administration an Abbreviated New Drug Application (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. Although the ultimate resolution of this matter is unknown, the legal fees associated with this patent challenge may have a significant impact on the Company s financial position or results of operations in future periods.

Note 13. Commitments and Contingencies

Leases

The Company leases certain manufacturing and office equipment, in the ordinary course of business, with initial lease terms not greater than 12 months. These assets are typically renewed annually. Rental and lease expense was not material for all periods presented. In addition, the Company owns all of its properties.

Note 14. Accumulated Other Comprehensive Loss

The Company s Accumulated Other Comprehensive Loss was comprised of the following components as of September 30, 2014 and 2013:

(In thousands)	September 30, 2014	September 30, 2013

Foreign Currency Translation				
Beginning Balance, July 1	$	(54)	$	(47)
Net gain (loss) on foreign currency translation (net of tax of $0 and $0)				(1)
Reclassifications to net income (net of tax of $0 and $0)				
Other comprehensive income (loss), net of tax				(1)
Ending Balance, September 30		(54)		(48)
Total Accumulated Other Comprehensive Loss	$	(54)	$	(48)

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Note 15. Earnings (Loss) Per Common Share

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

	Three Months Ended September 30, 2014	
(In thousands, except share and per share data)	**2014**	**2013**
Net Income (Loss) Attributable to Lannett Company, Inc.	$ 34,932	$ (5,995)
Basic weighted average common shares outstanding	35,597,931	29,586,237
Effect of potentially dilutive options and restricted stock awards	1,374,715	
Diluted weighted average common shares outstanding	36,972,646	29,586,237
Earnings (loss) per common share attributable to Lannett Company, Inc.:		
Basic	$ 0.98	$ (0.20)
Diluted	$ 0.94	$ (0.20)

The number of anti-dilutive shares that have been excluded in the computation of diluted earnings per share for the three months ended September 30, 2014 and 2013 were 436 thousand and 3.0 million, respectively.

Note 16. Share-based Compensation

At September 30, 2014, the Company had four share-based employee compensation plans (the 2003 Plan, the 2006 Long-term Incentive Plan (LTIP), or 2006 LTIP , the 2011 LTIP and the 2014 LTIP). Together these plans authorized an aggregate total of 8.1 million shares to be issued. The plans have a total of 2.5 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 September 30, 2014, there was $13.2 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 2.5 years.

Stock Options

The Company measures share-based compensation cost for options using the Black-Scholes option pricing model. The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the three months ended September 30, 2014 and 2013 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

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

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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 summary of stock option award activity as of September 30, 2014 and changes during the three 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 July 1, 2014	2,205	$ 7.84		
Granted	432	$ 34.79		
Exercised	(67)	$ 7.59	$ 2,120	
Forfeited, expired or repurchased	(1)	$ 16.19		
Outstanding at September 30, 2014	2,569	$ 12.38	$ 85,565	7.6
Vested and expected to vest at September 30, 2014	2,451	$ 11.93	$ 82,704	7.5
Exercisable at September 30, 2014	1,277	$ 6.36	$ 50,208	6.1

Restricted Stock

The Company measures restricted stock compensation costs based on the stock price at the grant date less an estimate for forfeitures. The annual forfeiture rate used to calculate compensation expense was 6.5% for the three months ended September 30, 2014 and 7.5% for the three months ended September 30, 2013.

A summary of restricted stock awards as of September 30, 2014 and changes during the three months then ended, is presented below:

(In thousands, except for weighted average price data)	Awards	Weighted Average Grant - date Fair Value	Aggregate Intrinsic Value
Non-vested at July 1, 2014	15	34.66	
Granted	98	36.77	
Vested	(9)	36.77	$ 345
Forfeited	(1)	36.77	
Non-vested at September 30, 2014	103	$ 36.47	

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 three months ended September 30, 2014 and 2013, 3 thousand shares and 6 thousand shares were issued under the ESPP, respectively. As of September 30, 2014, 429 thousand total cumulative shares have been issued under the ESPP.

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

	Three Months Ended September 30,	
(In thousands)	**2014**	**2013**
Selling, general and administrative	$ 1,359	$ 809
Research and development	120	38
Cost of sales	168	50
Total	$ 1,647	$ 897
Tax benefit at statutory rate	$ 570	$ 102

Note 17. 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 September 30, 2014 and 2013 were approximately $214 thousand and $159 thousand, respectively.

Note 18. Income Taxes

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

The federal, state and local income tax expense for the three months ended September 30, 2014 was $19.8 million compared to an income tax benefit of $4.2 million for the three months ended September 30, 2013. The effective tax rates were 36% and 41%, respectively. The effective tax rate for the three months ended September 30, 2014 was lower compared to the three months ended September 30, 2013 due primarily to a deferred tax benefit, resulting from an increase in statutory tax rate, relative to a pre-tax loss in the first quarter of Fiscal Year 2014. Additionally, a decrease in disqualifying dispositions of incentive stock awards relative to pre-tax income (loss) and higher tax credits for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 contributed to the lower effective tax rate.

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 September 30, 2014 and June 30, 2014, the Company reported total unrecognized benefits of $428 thousand, respectively. As a result of the positions taken during the period, the Company has not recorded any interest and penalties for the period ended September 30, 2014 in the statement of operations and no cumulative interest and penalties have been recorded either in the Company s statement of financial position as of September 30, 2014 and June 30, 2014. The Company will recognize interest accrued on unrecognized tax benefits in interest expense and any related penalties in operating expenses. The Company does not believe that the total unrecognized tax benefits will significantly increase or decrease in the next twelve months.

The Company files income tax returns in the United States federal jurisdiction, Pennsylvania, and New Jersey. The Company s tax returns for Fiscal Year 2008 and prior generally are no longer subject to review as such years generally are closed. The Company believes that an unfavorable resolution for open tax years would not be material to the financial position of the Company.

Note 19. Related Party Transactions

The Company had sales of $351 thousand and $510 thousand during the three months ended September 30, 2014 and 2013, respectively, to a generic distributor, Auburn Pharmaceutical Company (Auburn). Jeffrey Farber, Chairman of the Board and the son of William Farber, Chairman Emeritus of the Board of Directors and principal stockholder of the Company, is the owner of Auburn. Accounts receivable includes amounts due from Auburn of $257 thousand and $980 thousand at September 30, 2014 and June 30, 2014, respectively. In the Company s opinion, the terms of these transactions were not more favorable to Auburn than would have been to a non-related party.

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Note 20. 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 67% of the Company s inventory purchases in the three months ended September 30, 2014 and 2013, respectively.

On March 23, 2004, the Company entered into an agreement with JSP for the exclusive distribution rights in the United States to the current line of JSP products, in exchange for 4.0 million shares of the Company s common stock. The JSP products covered under the agreement included Butalbital, Aspirin, Caffeine with Codeine Phosphate Capsules; Digoxin Tablets; Levothyroxine Sodium Tablets, sold generically and under the brand name Unithroid®. 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; 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 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 agreement, the Company is required to use commercially reasonable efforts to purchase minimum dollar quantities of JSP products. Specifically, the Company is required to purchase, in the aggregate, $31 million of products from JSP each year. The Company has met the minimum purchase requirement for the first ten years of the contract, but there is no guarantee that the Company will be able to continue to do so in Fiscal 2015 and in the future. If the Company does not meet the minimum purchase requirements, JSP s sole remedy is to terminate the agreement.

Note 21. Cody Expansion Project

On December 20, 2012, the Company, through its subsidiaries Realty and Cody, entered into an agreement (the Agreement) with the City of Cody, Wyoming (City of Cody) and Forward Cody Wyoming, Inc. (Forward Cody), an unrelated non-profit corporation, which involves the construction of a building of approximately 24,000 square feet (the Project). As part of the Agreement, Cody was obligated to make an additional capital investment in its existing facilities in the amount of $5.2 million and create an additional 45 full time positions within three years starting June 30, 2011; Realty was required to contribute 1.66 acres of land to Forward Cody and enter into a 25 year lease agreement with Forward Cody for the Project. Realty will make annual rent payments totaling $108 thousand beginning on the date a Certificate of Occupancy permit is issued by the City of Cody and the Project is legally available for occupancy. Cody will sublease the property from Realty. Upon the fifth anniversary of occupancy, Realty may, at its discretion, purchase the Project from Forward Cody. The purchase option continues until Realty purchases the Project. Nothing in the Agreement should be deemed to create any relationship between Forward Cody and Realty other than the relationship of landlord and tenant.

In June 2014, the Company amended the Agreement including changing the size of the building, eliminating the requirements to contribute any land, and removing Realty as a party to the agreement. Additionally, Cody Labs is required to provide a capital contribution to the project in the amount of $565 thousand. None of the revisions are expected to be material to the Company s results of operations, financial position, or cashflows.

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

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, 2014.

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, the regulatory environment, including without limitation, reliance on key strategic alliances, availability of raw materials, fluctuations in operating results and other risks detailed from time to time in the Company s filings with the Securities and Exchange Commission. 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.

Company Overview

Lannett Company, Inc. (a Delaware corporation) and subsidiaries (the Company or Lannett) develop, manufacture, package, market, and distribute solid oral (tablets and capsules), extended release, topical, nasal, and oral solution finished dosage forms of drugs, that address a wide range of therapeutic areas. 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.

The Company operates pharmaceutical manufacturing plants in Philadelphia, Pennsylvania and Cody, Wyoming. Customers of the Company s pharmaceutical products 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.

Financial Summary

For the first quarter of Fiscal Year 2015, net sales increased to $93.4 million, representing 104% growth over the first quarter of Fiscal Year 2014. Gross profit increased to $71.6 million compared to $1.3 million in the prior year period and gross profit percentage increased to 77% compared to 3% in the prior year period. The first quarter of Fiscal Year 2014 included the impact of the nonrecurring JSP contract renewal charge which lowered gross profit by $20.1 million and the related gross profit percentage by 44% points, respectively.

R&D expenses increased 34% to $6.4 million compared to the first quarter of Fiscal Year 2014 while SG&A expenses increased 47% to $10.6 million from $7.2 million. Operating income for the first quarter of Fiscal Year 2015 was $54.7 million compared to an operating loss of $10.6 million in the first quarter of Fiscal Year 2014. The operating loss in the prior year period included the nonrecurring charge related to the JSP contract renewal. Net income for the first quarter of Fiscal Year 2015 was $34.9 million, or $0.94 per diluted share. Comparatively, net loss in the prior year was $6.0 million, or $0.20 per diluted share, and included the $12.7 million after-tax charge ($0.42 per diluted share) related to the JSP contract renewal. A more detailed discussion of the Company s financial results can be found below.

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Results of Operations - Three months ended September 30, 2014 compared with the three months ended September 30, 2013

Net sales increased 104% to $93.4 million for the three months ended September 30, 2014. The following table identifies the Company s net product sales by medical indication for the three months ended September 30, 2014 and 2013:

(In thousands)	Three Months Ended September 30,	
Medical Indication	**2014**	**2013**
Antibiotic	$ 3,003	$ 3,375
Cardiovascular	18,939	4,524
Gallstone	11,761	1,366
Glaucoma	4,691	1,455
Gout	2,299	2,053
Migraine	5,795	2,715
Obesity	915	1,131
Pain Management	6,655	5,218
Thyroid Deficiency	33,346	20,027
Other	5,983	3,965
Total	$ 93,387	$ 45,829

Product price increases contributed $52.4 million to the overall increase in net sales, partially offset by decreased volumes of $4.8 million. The Company experienced favorable trends in product pricing on several key products during the period, as discussed below. Although the Company has benefited from these favorable pricing trends, the level of competition in the marketplace is constantly changing and the Company cannot guarantee that these pricing trends will continue.

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

Medical indication	**Sales volume change %**	**Sales price change %**
Antibiotic	5%	(16)%
Cardiovascular	(29)%	347%
Gallstone	(44)%	805%
Glaucoma	(6)%	228%
Gout	9%	3%
Migraine	(23)%	136%
Obesity	4%	(23)%
Pain Management	11%	17%
Thyroid Deficiency	(20)%	87%

Cardiovascular. Net sales of drugs used for cardiovascular treatment increased by $14.4 million, primarily as a result of price increases on products used to treat various cardiac conditions. The increase in net sales was partially offset by volume decreases on several products within the indication.

Thyroid Deficiency. Net sales of drugs used for the treatment of thyroid deficiency increased by $13.3 million, primarily as a result of price increases on key products, partially offset by decreased volumes. Above average customer purchases in the fourth quarter of Fiscal Year 2014, in anticipation of a price increase effective in the first quarter of Fiscal Year 2015, led to lower volumes in the first quarter of Fiscal Year 2015. The Company expects volumes to normalize in the remaining quarters of Fiscal Year 2015.

Gallstone. Net sales of drugs used for gallstones increased by $10.4 million. The increase in net sales was primarily attributable to price increases, partially offset by decreased volumes.

Glaucoma. Net sales of drugs used for the treatment of Glaucoma increased by $3.2 million. The increase in net sales was primarily attributable to price increases.

Migraine. Net sales of drugs used to treat migraines increased by $3.1 million. The increase in net sales was attributable to price increases on key products, partially offset by decreased volumes.

Pain Management. Net sales of pain management products increased $1.4 million. The increase in net sales was mainly attributable to price and volume increases on the Company s C-Topical® Solution product. The Company continues to actively market its C- Topical® Solution product utilizing a group of brand representatives in anticipation of an NDA filing. Additionally, the Company s

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Oxycodone HCl Oral Solution product, which was recently approved by the FDA, contributed to the increase in net sales. The Company launched the product during the second half of September 2014.

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 September 30:

(In thousands) Customer Distribution Channel	September 30, 2014	September 30, 2013
Wholesaler/Distributor	$ 67,334	$ 27,776
Retail Chain	14,385	14,655
Mail-Order Pharmacy	11,668	3,398
Total	$ 93,387	$ 45,829

Net sales to wholesaler/distributor increased as a result of increased sales in a variety of products for thyroid deficiency, gallstones and cardiovascular, as discussed above. Additionally, the increase in net sales to wholesaler/distributor was impacted by the strategic partnership between Amerisource Bergen and Walgreens, whereby Amerisource Bergen began product distribution on behalf of Walgreens in third quarter of Fiscal Year 2014. Mail-order pharmacy net sales increased primarily as a result of increased sales of drugs used for the treatment of thyroid deficiency, as discussed above.

Cost of Sales. Cost of sales for the first quarter of Fiscal Year 2015 decreased $22.7 million to $21.8 million. The decrease was primarily attributable to the nonrecurring $20.1 million charge related to the JSP contract renewal recorded in the first quarter of Fiscal Year 2014. The remaining decrease primarily reflected the impact of decreased volumes, partially offset by increased provisions for excess and obsolete inventory totaling $889 thousand related to certain products. Amortization expense included in cost of sales totaled $20 thousand for the first quarter of Fiscal Year 2015 and $470 thousand for the first quarter of Fiscal Year 2014.

Gross Profit. Gross profit percentages for the first quarter of Fiscal Year 2015 and 2014 were 77% and 3%, respectively. The charge related to the JSP contract renewal negatively impacted gross margin percentage by 44% points in the first quarter of Fiscal Year 2014. The remaining increase in gross profit percentage was due to product price increases.

The Company is continuously seeking to keep product costs low, however there can be no guarantee that gross profit percentages will stay consistent in future periods. Pricing pressure from competitors and costs of producing or purchasing new drugs may also fluctuate in future periods. Changes in future product sales mix may also occur.

Research and Development. Research and development expenses for the first quarter increased 34% to $6.4 million in Fiscal Year 2015 from $4.7 million in Fiscal Year 2014. The increase is primarily due to increased costs for products in development totaling $1.4 million, specifically related to new requirements enacted under the Generic Drug User Fee Amendments which require the Company to provide additional product submission batches and stability data. Additional increases were related to compensation-related costs partially offset by a decrease in third-party laboratory services.

Selling, General and Administrative. Selling, general and administrative expenses increased 47% to $10.6 million in the first quarter of Fiscal Year 2015 compared with $7.2 million in Fiscal Year 2014. The increase is primarily due to additional compensation-related costs of $873 thousand, expenses related to marketing the Company s C-Topical® Solution product totaling $600 thousand, as well as other professional service and consulting fees totaling $883 thousand.

The Company is focused on controlling selling, general and administrative costs, however increases in personnel and other costs to facilitate enhancements in the Company s infrastructure and expansion may impact selling, general and administrative expenses in future periods.

Other Income (Expense). Interest expense for the three months ended September 30, 2014 totaled $38 thousand compared to $58 thousand for the three months ended September 30, 2014. Interest and dividend income totaling $102 thousand for the three months ended September 30, 2014 was higher compared with $46 thousand for the prior year period. The Company also recorded a net gain on investment securities during the three months ended September 30, 2014 totaling $15 thousand compared to a net gain on investment securities totaling $463 thousand in the prior year period.

Income Tax. The Company recorded income tax expense in the first quarter of Fiscal Year 2015 of $19.8 million compared to an income tax benefit of $4.2 million in the first quarter of Fiscal Year 2014. The effective tax rate for the three months ended September 30, 2014 was 36%, compared to 41% for the three months ended September 30, 2013. The effective tax rate for the three months ended September 30, 2014 was lower compared to the three months ended September 30, 2013 due primarily to a deferred tax benefit, resulting from an increase in statutory tax rate, relative to a pre-tax loss recorded in the first quarter of Fiscal Year 2014.

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Additionally, a decrease in disqualifying dispositions of incentive stock awards relative to pre-tax income (loss) and higher tax credits for the three months ended September 30, 2014 compared to the three months ended September 30, 2013 contributed to the lower effective tax rate.

Net Income. For the three months ended September 30, 2014, the Company reported net income attributable to Lannett Company, Inc. of $34.9 million, or $0.94 per diluted share. Comparatively, net loss in the prior year was $6.0 million, or $0.20 per diluted share. Net loss attributable to Lannett Company, Inc. in the prior year included the nonrecurring charge related to the JSP contract renewal equal to $12.7 million after-tax, or $0.42 per diluted share.

Liquidity and Capital Resources

Cash Flow

The Company has historically financed its operations with cash flow generated from operations, supplemented with borrowings from various government agencies and financial institutions. At September 30, 2014, working capital was $247.4 million as compared to $218.5 million at June 30, 2014, an increase of $28.9 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 $14.4 million for the three months ended September 30, 2014 reflected a net income of $35.0 million, adjustments for non-cash items of $776 thousand, as well as cash used by changes in operating assets and liabilities of $21.4 million. In comparison, net cash used in operating activities of $5.0 million for the three months ended September 30, 2013 reflected a net loss of $6.0 million, adjustments for non-cash items of $18.7 million, as well as cash used by changes in operating assets and liabilities of $17.7 million.

Significant changes in operating assets and liabilities from June 30, 2014 to September 30, 2014 were comprised of:

- An increase in accounts receivable of $14.5 million mainly due to an increase in gross accounts receivable resulting from increased sales partially offset by increases in total revenue-related reserves. The Company s days sales outstanding (DSO) at September 30, 2014, based on gross sales for the three months ended September 30, 2014 and gross accounts receivable at September 30, 2014, was 60 days. The level of DSO at September 30, 2014 was comparable to the Company s expectation that DSO will be in the 60 to 70 day range based on 60 day payment terms for most customers.

- An increase in income taxes payable totaling $9.7 million. The amount was mainly due to pre-tax income for the three months ended September 30, 2014, partially offset by estimated tax payments.

- A decrease in accounts payable of $7.0 million due to the timing of payments at the beginning of Fiscal Year 2015.

- A decrease in accrued payroll and payroll related costs of $9.0 million primarily related to Fiscal Year 2015 payments of incentive compensation and tax withholdings accrued in Fiscal Year 2014 partially offset by incentive compensation costs accrued during Fiscal Year 2015.

Significant changes in operating assets and liabilities from June 30, 2013 to September 30, 2013 were comprised of:

- An increase in accounts receivable of $3.3 million mainly due to an increase in gross accounts receivable as a result of increased sales, partially offset by increases in total revenue-related reserves. The Company s days sales outstanding (DSO) at September 30, 2013, based on gross sales for the three months ended September 30, 2013 and gross accounts receivable at September 30, 2013, was 60 days. The level of DSO at September 30, 2013 was comparable to the Company s expectation that DSO will be in the 60 to 70 day range based on 60 day payment terms for most customers.

- An increase in income taxes receivable and a decrease in income taxes payable totaling $2.9 million. The amount was mainly due to the timing of estimated tax payments during Fiscal Year 2014, in addition to a pre-tax loss for the three months ended September 30, 2013.

- An increase in inventories of $2.0 million primarily due to the timing of customer order fulfillment and inventory on hand related to new product approvals.

- A decrease in accounts payable of $6.0 million due to the timing of payments at the beginning of Fiscal Year 2014.

- A decrease in accrued payroll and payroll related costs of $3.9 million primarily related to Fiscal Year 2014 payments of incentive compensation accrued in Fiscal Year 2013, partially offset by incentive compensation costs accrued during Fiscal Year 2014.

Net cash provided by investing activities of $16.2 million, for the three months ended September 30, 2014, was mainly the result of proceeds from the sale of investment securities of $34.2 million partially offset by purchases of investment securities totaling $8.4 million and purchases of property, plant and equipment of $9.4 million. Net cash used in investing activities of $3.1 million for the

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three months ended September 30, 2013 was mainly the result of purchases of investment securities of $5.7 million and purchases of property, plant and equipment of $2.0 million, partially offset by proceeds from the sale of investment securities of $4.6 million.

Net cash provided by financing activities of $1.2 million for the three months ended September 30, 2014 was primarily due to proceeds from the issuance of stock pursuant to stock compensation plans of $773 thousand and excess tax benefits on share-based compensation awards of $495 thousand, partially offset by scheduled payments of debt of $32 thousand. Net cash provided by financing activities of $1.2 million for the three months ended September 30, 2013 was primarily due to proceeds from the issuance of stock pursuant to stock compensation plans of $881 thousand and excess tax benefits on share-based compensation awards of $407 thousand, partially offset by scheduled payments of debt of $127 thousand.

Credit Facilities

The Company has previously entered into and may enter future agreements with various government agencies and financial institutions to provide additional cash to help finance the Company s various capital investments and potential strategic opportunities. These borrowing arrangements as of September 30, 2014 are as follows:

In December 2013, the Company entered into a credit agreement (the Citibank Line of Credit) with Citibank, N.A., as administrative agent, and another financial institution. The Citibank Line of Credit provides for a revolving loan commitment in the amount of up to $50.0 million. Any loans under the Citibank Line of Credit will bear interest at either a Eurodollar Rate or a Base Rate plus a specified margin. The Company is also required to pay a commitment fee on any undrawn commitments under the Citibank Line of Credit ranging from 0.2% - 0.3% per annum according to the average daily balance of borrowings under the agreement. The Citibank Line of Credit is collateralized by substantially all of the Company s assets. In connection with securing the Citibank Line of Credit, the Company repaid substantially all of its outstanding debt. As of September 30, 2014 and June 30, 2014, the Company had $50.0 million available under the Citibank Line of Credit.

The Citibank Line of Credit contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for credit facilities of this type. As of September 30, 2014 and June 30, 2014, the Company was in compliance with all financial covenants.

The Company is the primary beneficiary to a VIE called Realty. The VIE owns land and a building which is being leased to Cody Labs. A mortgage loan with First National Bank of Cody has been consolidated in the Company s financial statements, along with the related land and building. The mortgage requires monthly principal and interest payments of $15 thousand. As of September 30, 2014 and June 30, 2014, the effective rate was 4.5%. The mortgage is collateralized by the land and building with a net book value of $1.5 million. As of September 30, 2014, $1.1 million is outstanding under the mortgage loan, of which $131 thousand is classified as currently due.

Other Liquidity Matters

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.

Research and Development Arrangements

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

Prospects for the Future

Lannett continues to experience substantial improvement year over year in many important financial metrics. Each year, our knowledge, skills and talent increase, as the Company learns from its experience. The Company is strengthening and building momentum to push to the next level within the generic pharmaceutical industry. There are several strategic initiatives on which the Company is embarking to continue its growth.

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One initiative at the core of the Company s strategy is to continue leveraging the asset we acquired in 2007, Cody Labs. In July 2008, the DEA granted Cody Labs a license to directly import concentrated poppy straw for conversion into opioid-based APIs for use in various dosage forms for pain management. The value of this license comes from the fact that, to date, only six other companies in the U.S. have been granted this license. This license, along with Cody Labs expertise in API development and manufacture, allows the Company to perform in a market with high barriers to entry, no foreign competition, and limited domestic competition. Because of this vertical integration, the Company has direct control of its supply and can avoid increased costs associated with buying APIs from third-party manufacturers, thereby achieving higher margins. The Company can also leverage this vertical integration not only for direct supply of opioid-based APIs, but also for the manufacture of non-opioid-based APIs.

The Company believes that the demand for controlled substance, pain management drugs will continue to grow as the Baby Boomer generation ages. By concentrating additional resources in the development of opioid-based APIs and dosage forms, the Company is well-positioned to take advantage of this opportunity. The Company is currently vertically integrated on two products, with several others in various stages of development.

One product which the Company manufactures is a cocaine hydrochloride solution. This product is being manufactured and marketed under the brand name C-Topical® Solution. This product is an analgesic topical solution, with vasoconstriction as a side effect, for use primarily by ear, nose and throat doctors during surgical procedures. This product represents the Company s first foray into the brand market. Selling brand versus generic products requires a dedicated sales force to detail and educate physicians on the product. The Company strongly believes that C-Topical®, once the clinical trials are completed and the FDA has granted approval, will be an important contributor to total revenue, with higher than average profit margins as a result of vertical integration.

The Company s strategic goal is to continue investing in controlled substance product development so that, within five years, at least 50% of revenues from manufactured products are derived from controlled substance products which carry with them higher-than-average gross margins. As the Company continues to invest in, and focus, on process and manufacturing optimization, Cody Labs will continue to be an important part of our future growth plan.

In addition to focusing on the development and manufacture of opioid-based APIs and dosage forms, the Company has made a strategic decision to develop products, both in-house and with external partners, which require a paragraph four (P-IV) certification when filing the ANDA. A P-IV certification is required when an ANDA is submitted for a product for which the innovator s patent has not expired. The certification must state whether the patent on the reference listed drug (RLD) is being challenged on grounds of it being invalid, or if the patent is being circumvented. This path to product approval represents a major opportunity for generic drug companies because they do not have to wait until a particular patent expires to potentially enter the market. Secondly, if a company is the first to file a P-IV on a product, and they successfully invalidate or circumvent the patent, the FDA may grant 180 days of market exclusivity. This allows the generic manufacturer to be the sole competitor to the brand company for six months, during which time it will capture a significant portion of the market from the brand company, albeit at lower prices.

One challenge for generic manufacturers with this strategy is the level of legal costs required. Before a product is selected for development, the Company must perform a thorough review of the existing patents and determine if they are going to try to invalidate the patent or try to circumvent it. In either case, once the Company submits a P-IV the brand company will have 45 days to respond with a determination on whether they are going to file a suit against the generic company to defend their patent. A generic company needs to be prepared not only for the time and effort associated with a protracted legal challenge, but the associated fees which can easily reach in excess of several million dollars. This strategy provides a high risk, high reward path to product approval. The Company filed its first ANDA with a P-IV certification in Fiscal Year 2013. To date, we have filed five paragraph IV certifications. In response to our paragraph IV certification with respect to the Zomig® nasal spray product, AstraZeneca AB, AstraZeneca UK Limited and Impax Laboratories, Inc. filed two patent infringement complaints

against the Company in July 2014. With the right research and analysis performed up front, the Company believes it can target suitable products for which to file a P-IV certification, be successful, and reap the rewards of limited competition.

Another area of focus for the Company relates to mergers, acquisitions and other strategic alliances, whether new or continuing. The Company is party to supply and development agreements with international companies, including, Azad Pharma AG, Swiss Caps of Switzerland, Pharma 2B (formerly Pharmaseed), The GC Group of Israel and HEC Pharm Group, as well as domestic companies, including JSP, Cerovene, and Summit Bioscience LLC. The Company is currently in negotiations on similar agreements with other companies, and is actively seeking additional strategic partnerships, through which it will market and distribute products manufactured in-house or by third parties.

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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 estimate was 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, 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 revenue is made for chargebacks, rebates, returns, promotional adjustments, and other potential adjustments. These provisions are primarily estimated based on historical experience, future expectations, contractual arrangements with wholesalers and indirect customers, and other factors known to management at the time of accrual. Accruals for provisions are presented in the Consolidated Financial Statements as a reduction to gross sales with the corresponding reserve presented as a reduction of accounts receivable or included as rebates payable. The reserves presented as a reduction of accounts receivable totaled $57.4 million and $51.9 million at September 30, 2014 and June 30, 2014, respectively. Rebates payable at September 30, 2014 and June 30, 2014 included $6.2 million and $4.6 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.

The following table identifies the activity and ending balances of each major category of revenue reserve for the three months ended September 30, 2014 and 2013:

Reserve Category					
(In thousands)	**Chargebacks**	**Rebates**	**Returns**	**Other**	**Total**
Balance at July 1, 2014	$ 30,320	$ 15,091	$ 9,341	$ 1,787	$ 56,539
Current period provision	77,863	18,551	4,090	8,992	109,496
Credits issued during the period	(75,405)	(16,527)	(1,469)	(9,070)	(102,471)
Balance at September 30, 2014	$ 32,778	$ 17,115	$ 11,962	$ 1,709	$ 63,564

Reserve Category (In thousands)	Chargebacks	Rebates	Returns	Other	Total
Balance at July 1, 2013	$ 7,267	$ 3,581	$ 6,689	$ 1,000	$ 18,537
Current period provision	17,734	7,489	1,207	3,863	30,293
Credits issued during the period	(16,221)	(5,905)	(941)	(3,545)	(26,612)
Balance at September 30, 2013	$ 8,780	$ 5,165	$ 6,955	$ 1,318	$ 22,218

For the three months ending September 30, 2014 and 2013, as a percentage of gross sales the provision for chargebacks was 38.4% and 23.3%, the provision for rebates was 9.1% and 9.8%, the provision for returns was 2.0% and 1.6%, and the provision for other adjustments was 4.4% and 5.1%, respectively.

The increase in total reserves from June 30, 2014 to September 30, 2014 was due to an increase in substantially all reserve categories. The increases resulted from increased gross sales to wholesalers as a result of the strategic partnership between Amerisource Bergen and Walgreens, whereby Amerisource Bergen began product distribution on behalf of Walgreens in third quarter of Fiscal Year 2014. The activity in the Other category for the three months ended September 30, 2014 and 2013 includes shelf-stock, shipping and other sales adjustments including prompt payment discounts. 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.

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

Chargebacks

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

Rebates

Rebates are offered to the Company s key chain drug store, distributor and wholesaler customers to promote customer loyalty and increase product sales. These rebate programs provide customers with credits upon attainment of pre-established volumes or attainment of net sales milestones for a specified period. Other promotional programs are incentive programs offered to the customers. Additionally, as a result of the Patient Protection and Affordable Care Act (PPACA) enacted in the U.S. in March 2010, the Company participates in a new cost-sharing program for certain Medicare Part D beneficiaries designed primarily for the sale of brand drugs and certain generic drugs if their FDA approval was granted under a New Drug Application (NDA) or 505(b) NDA versus an Abbreviated New Drug Application (ANDA). Because our drugs used for the treatment of thyroid deficiency and our Morphine Sulfate Oral Solution product were both approved by the FDA as 505(b)(2) NDAs, they are considered brand drugs for purposes of the PPACA. Drugs purchased within the Medicare Part D coverage gap (commonly referred to as the donut hole) result in additional rebates. The Company estimates the reserve for rebates and other promotional credit programs based on the specific terms in each agreement when revenue is recognized. The reserve for rebates increases (decreases) as sales to certain wholesale and retail customers increase (decrease). However, since these rebate programs are not identical for all customers, the size of the reserve will depend on the mix of sales to customers that are eligible to receive rebates.

Returns

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

established reserve. Generally, the reserve for returns increases as net sales increase.

Other Adjustments

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

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Inventories

Inventories are stated at the lower of cost or market determined by the first-in, first-out method. Inventories are regularly reviewed and provisions for excess and obsolete inventory are recorded based primarily on current inventory levels and estimated sales forecasts. During the three months ended September 30, 2014 and 2013 the Company recorded provisions for excess and obsolete inventory of $1.6 million and $692 thousand, respectively.

Income Taxes

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

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

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

Valuation of Long-Lived Assets

The Company s long-lived assets primarily consist of property, plant and equipment as well as definite-lived intangible assets. Intangible assets are stated at cost less accumulated amortization and were not material to the consolidated financial statements at September 30, 2014 or June 30, 2014. Amortization is computed on a straight-line basis over the assets estimated useful lives, generally for periods ranging from 10 to 15 years. Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the assets estimated useful lives, generally for periods ranging from 5 to 39 years. The Company continually evaluates the reasonableness of the useful lives of these assets.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances (triggering events) indicate that the carrying amount of the asset may not be recoverable. The nature and timing of triggering events by their very nature are unpredictable; however

management regularly considers the performance of an asset as compared to its expectations, industry events, industry and economic trends, as well as any other relevant information known to management when determining if a triggering event occurred.

If a triggering event is determined to have occurred, the first step in the impairment test is to compare the asset s carrying value to the undiscounted cash flows expected to be generated by the asset. If the carrying value exceeds the undiscounted cash flow of the asset then impairment exists. An impairment loss is measured as the excess of the asset s carrying value over its fair value, which in most cases is calculated using a discounted cash flow model. Discounted cash flow models are highly reliant on various assumptions which are considered Level 3 inputs, including estimates of future cash flows (including long-term growth rates), discount rates, and the probability of achieving the estimated cash flows.

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

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The following table presents the weighted average assumptions used to estimate fair values of the stock options granted during the three months ended September 30, 2014 and 2013 and the estimated annual forfeiture rates used to recognize the associated compensation expense:

	September 30, 2014	September 30, 2013
Risk-free interest rate	1.7%	2.1%
Expected volatility	52.1%	62.9%
Expected dividend yield	0.0%	0.0%
Forfeiture rate	6.5%	7.5%
Expected term (in years)	5.5 years	5.9 years

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

Recent Accounting Pronouncements

In May 2014, the FASB issued authoritative guidance on revenue recognition. 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, 2016. Early application is not permitted. The Company is currently in the process of assessing the impact this guidance will have on the consolidated financial statements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A mortgage loan with First National Bank of Cody has been consolidated in the Company s financial statements, along with the related land and building. The mortgage requires monthly principal and interest payments of $15 thousand. As of September 30, 2014 and June 30, 2014, the effective interest rate was 4.5%. The mortgage is collateralized by the land and building with a net book value of $1.5 million. As of September 30, 2014, $1.1 million is outstanding under the mortgage loan.

In December 2013, the Company entered into a credit agreement (the Citibank Line of Credit) with Citibank, N.A., as administrative agent and certain other financial institutions. The Citibank Line of Credit provides for a revolving loan commitment in the amount of up to $50.0 million. Any loans under the Citibank Line of Credit will bear interest at either a Eurodollar Rate or a Base Rate plus a specified margin. The Company is also required to pay a commitment fee on any undrawn commitments under the Citibank Line of Credit ranging from 0.2% - 0.3% per annum according to the average daily balance of borrowings under the agreement. The Citibank Line of Credit is collateralized by substantially all of the Company s assets. As of September 30, 2014 and June 30, 2014, the Company had $50.0 million available under the Citibank Line of Credit.

The Citibank Line of Credit contains representations and warranties, affirmative, negative and financial covenants, and events of default, applicable to the Company and its subsidiaries which are customary for credit facilities of this type. As of September 30, 2014 and June 30, 2014, the Company was in compliance with all financial covenants.

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Change in Internal Control Over Financial Reporting

There has been no change in Lannett s internal control over financial reporting during the three months ended September 30, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information pertaining to legal proceedings can be found in Note 12. Legal and Regulatory Matters 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, 2014 includes a detailed description of its risk factors.

ITEM 6. EXHIBITS

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

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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: November 6, 2014	By:	/s/ Arthur P. Bedrosian Arthur P. Bedrosian President and Chief Executive Officer
Dated: November 6, 2014	By:	/s/ Martin P. Galvan Martin P. Galvan Vice President of Finance, Chief Financial Officer and Treasurer
Dated: November 6, 2014	By:	/s/ G. Michael Landis G. Michael Landis Director of Financial Reporting and Principal Accounting Officer

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Exhibit Index

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