INTERPHARM HOLDINGS INC
Form 10-Q
February 14, 2007

**SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended December 31, 2006

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

For the Transition Period from _____________ to _____________

Commission File Number 0-22710

**INTERPHARM HOLDINGS, INC**.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 13-3673965 |
| State or other jurisdiction of corporation or organization) | (I.R.S. Employer Identification Number) |
| 75 Adams Avenue, Hauppauge, New York | 11788 |
| (Address of principal executive offices) | (Zip Code) |

Issuer's telephone number, including area code (631) 952-0214

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

YES x NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

YES o NO x

As of the close of business on February 13, 2007, there were 65,569,122 shares of the Registrant's $0.01 par value per share Common Stock outstanding.

INTERPHARM HOLDINGS, INC.

TABLE OF CONTENTS

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

| | December 31, 2006 (Unaudited) | June 30, 2006 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | $ 6,879 | $ 1,438 |
| Accounts receivable, net | 11,345 | 14,212 |
| Inventories | 9,807 | 8,706 |
| Prepaid expenses and other current assets | 1,650 | 1,316 |
| Deferred tax assets | 56 | 1,321 |
| Total Current Assets | 29,737 | 26,993 |
| Land, building and equipment, net | 30,664 | 29,069 |
| Deferred tax assets | 7,069 | 4,849 |
| Investment in APR, LLC | 1,023 | 1,023 |
| Other assets | 604 | 933 |
| TOTAL ASSETS | $ 69,097 | $ 62,867 |

*See Notes To Condensed Consolidated Financial Statements.*

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY

| | December 31, 2006 (Unaudited) | June 30, 2006 |
|---|---|---|
| CURRENT LIABILITIES | | |
| Current maturities of long-term debt | $ 1,808 | $ 1,686 |
| Accounts payable, accrued expenses and other liabilities | 13,235 | 12,650 |
| Deferred revenue | — | 3,399 |
| Total Current Liabilities | 15,043 | 17,735 |
| | | |
| OTHER LIABILITIES | | |
| Long-term debt, less current maturities | 13,797 | 13,952 |
| Contract termination liability | 1,304 | — |
| Other liabilities | 11 | 125 |
| | | |
| Total Other Liabilities | 15,112 | 14,077 |
| | | |
| TOTAL LIABILITIES | 30,155 | 31,812 |
| | | |
| COMMITMENTS AND CONTINGENCIES | | |
| | | |
| Series B-1 Redeemable Convertible Preferred Stock: | | |
| 15 shares authorized; issued and outstanding - 10 at December 31, and June 30, 2006; liquidation preference of $10,000 | 8,155 | 8,225 |
| | | |
| Series C-1 Redeemable Convertible Preferred Stock: | | |
| 10 shares authorized; issued and outstanding - 10 at December 31, 2006; liquidation preference of $10,000 | 8,352 | — |
| | | |
| STOCKHOLDERS' EQUITY | | |
| Preferred stocks, 10,000 shares authorized; issued and outstanding - 5,132 and 5,141, respectively; aggregate liquidation preference of $3,588 and $4,291, respectively | 51 | 51 |
| Common stock, $0.01 par value, 150,000 and 65,148 shares authorized and issued, respectively, at December 31, 2006, and 70,000 and 64,537 shares authorized and issued, respectively, at June 30, 2006. | 651 | 645 |
| Additional paid-in capital | 28,126 | 24,196 |
| Stock subscription receivable | (34) | (90) |
| Accumulated other comprehensive income | 83 | 98 |
| Accumulated deficit | (6,442) | (2,070) |
| | | |
| TOTAL STOCKHOLDERS' EQUITY | 22,435 | 22,830 |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 69,097 | $ 62,867 |

*See Notes To Condensed Consolidated Financial Statements.*

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(In thousands, except per share data)

| | Three Months Ended December 31, 2006 | Three Months Ended December 31, 2005 | Six Months Ended December 31, 2006 | Six Months Ended December 31, 2005 |
|---|---|---|---|---|
| SALES, Net | $ 17,479 | $ 16,213 | $ 40,305 | $ 30,760 |
| COST OF SALES (including related-party rent expense of $140 and $242 for the three and six months ended December 31, 2006 and $102 and $204 for the three and six months ended December 31, 2005, respectively) | 13,443 | 11,034 | 27,292 | 21,597 |
| GROSS PROFIT | 4,036 | 5,179 | 13,013 | 9,163 |
| OPERATING EXPENSES | | | | |
| Selling, general and administrative | 3,156 | 2,201 | 5,794 | 4,639 |
| Related party rent | 25 | 18 | 43 | 36 |
| Research and development | 4,871 | 1,885 | 8,289 | 4,031 |
| TOTAL OPERATING EXPENSES | 8,052 | 4,104 | 14,126 | 8,706 |
| OPERATING (LOSS) INCOME | (4,016) | 1,075 | (1,113) | 457 |
| OTHER EXPENSE | | | | |
| Contract termination expense | (1,655) | — | (1,655) | — |
| Interest expense, net | (240) | (99) | (527) | (190) |
| Other | (121) | (7) | (121) | (7) |
| TOTAL OTHER EXPENSE | (2,016) | (106) | (2,303) | (197) |
| (LOSS) INCOME BEFORE INCOME TAXES | (6,032) | 969 | (3,416) | 260 |
| (BENEFIT FROM) PROVISION FOR INCOME TAXES | (1,908) | 360 | (922) | 98 |
| NET (LOSS) INCOME | (4,124) | 609 | (2,494) | 162 |
| Series C-1 preferred stock beneficial conversion feature | — | — | 1,094 | — |
| Preferred stock dividends | 453 | 67 | 742 | 90 |
| NET (LOSS) INCOME ATTRIBUTABLE TO COMMON | $ (4,577) | $ 542 | $ (4,330) | $ 72 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| STOCKHOLDERS | | | | | | | | |
| | | | | | | | | |
| EARNINGS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS | | | | | | | | |
| Basic (loss) earnings per share | $ | (0.07) | $ | 0.02 | $ | (0.07) | $ | 0.00 |
| Diluted (loss) earnings per share | $ | (0.07) | $ | 0.01 | $ | (0.07) | $ | 0.00 |
| | | | | | | | | |
| Basic weighted average shares outstanding | | 65,063 | | 32,464 | | 64,892 | | 32,464 |
| Diluted weighted average shares and equivalent shares outstanding | | 65,063 | | 67,555 | | 64,892 | | 67,401 |

*See Notes To Condensed Consolidated Financial Statements.*

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(UNAUDITED)
(In thousands)

| | Preferred Stock | | Common Stock | | | | Accumulated Other | Retained | |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Paid-In Capital | Subscription Receivable | Comprehensive Income | Earnings (Deficit) | Stockholders' Equity |
| BALANCE - July 1, 2006 | 5,141 | $ 51 | 64,537 | $ 645 | $ 24,196 | $ (90) | $ 98 | $ (2,070) | $ 22,830 |
| Accrued dividends - Series B-1 | — | — | — | — | — | — | — | (206) | (206) |
| Accrued dividends - Series C-1 | — | — | — | — | — | — | — | (206) | (206) |
| Series C-1 Preferred beneficial conversion feature | — | — | — | — | 1,094 | — | — | (1,094) | — |
| Series B-1 dividends paid with common stock | — | — | 204 | 2 | 283 | — | — | (207) | 78 |
| Series C-1 dividends paid with common stock | | | 28 | — | 41 | — | — | (41) | — |
| Dividends declared - Series A-1 | — | — | | — | — | — | — | (124) | (124) |
| Shares issued for options exercised | — | — | 370 | 4 | 254 | — | — | — | 258 |
| Tax benefit in connection with exercise of options | — | — | — | — | 31 | — | — | — | 31 |
| Conversion of Series A preferred stock | (7) | — | 7 | — | — | — | — | — | — |
| Conversion of Series B preferred stock | (2) | — | 2 | — | — | — | — | — | — |
| Fair value of warrants issued | — | — | — | — | 1,641 | — | — | — | 1,641 |
| Stock based compensation and modification expense | — | — | — | — | 586 | — | — | — | 586 |
| Collections on stock subscription receivable | — | — | — | — | — | 56 | — | — | 56 |
| Change in fair value of interest rate swap | — | — | — | — | — | — | (15) | — | (15) |
| Net loss | — | — | — | — | — | — | — | (2,494) | (2,494) |
| BALANCE - December 31, 2006 | 5,132 | $ 51 | 65,148 | $ 651 | $ 28,126 | $ (34) | $ 83 | $ (6,442) | $ 22,435 |

*See Notes To Condensed Consolidated Financial Statements.*

4

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (UNAUDITED)
(In thousands)

| | Three Months Ended December 31, 2006 | Three Months Ended December 31, 2005 | Six Months Ended December 31, 2006 | Six Months Ended December 31, 2005 |
|---|---|---|---|---|
| NET (LOSS) INCOME | $ (4,124) | $ 609 | $ (2,494) | $ 162 |
| OTHER COMPREHENSIVE INCOME | | | | |
| Change in fair value of interest rate swap | (29) | — | (15) | — |
| TOTAL COMPREHENSIVEINCOME (LOSS) | $ (4,153) | $ 609 | $ (2,509) | $ 162 |

*See Notes To Condensed Consolidated Financial Statements.*

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

| | Six Months Ended December 31, 2006 | Six Months Ended December 31, 2005 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net (loss) income | $ (2,494) | $ 162 |
| Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities: | | |
| Bad debt expense | 55 | 11 |
| Accreted non-cash interest expense | 21 | — |
| Depreciation and amortization | 1,098 | 685 |
| Vested options expense | 586 | 416 |
| Contract termination expense | 1,655 | — |
| Excess tax benefit from exercise of stock options | (31) | — |
| Deferred tax expense | (922) | 98 |
| Other | 121 | 7 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,812 | 608 |
| Inventories | (1,101) | (403) |
| Prepaid expenses and other current assets | (360) | (323) |
| Accounts payable, accrued expenses and other liabilities | (236) | 4,373 |
| Deferred revenue | (3,399) | 1,637 |
| TOTAL ADJUSTMENTS | 299 | 7,109 |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (2,195) | 7,271 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchases of building and equipment | (2,200) | (4,589) |
| Deposits and other long-term assets | (120) | (111) |
| NET CASH USED IN INVESTING ACTIVITIES | (2,320) | (4,700) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from sale of Series C-1 preferred stock and warrants, net | 9,993 | — |
| Expenditures relating to sale of Series B-1 preferred stock and warrants | (70) | — |
| Proceeds from options exercised | 258 | — |
| Proceeds from long-term debt | 690 | 3,630 |
| Payment of Series A-1 dividends | (124) | (165) |
| Collections on stock subscription receivable | 56 | 21 |
| Excess tax benefit from exercise of stock options | 31 | — |
| Repayments of long-term debt | (878) | (200) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 9,956 | 3,286 |
| NET INCREASE IN CASH | 5,441 | 5,857 |
| CASH - Beginning | 1,438 | 537 |

| | | | | |
|---|---|---|---|---|
| CASH - Ending | $ | 6,879 | $ | 6,394 |

*See Notes To Condensed Consolidated Financial Statements.*

INTERPHARM HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(UNAUDITED)
(In thousands)

| | Six Months Ended December 31, 2006 | Six Months Ended December 31, 2005 |
|---|---|---|
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Cash paid during the periods for: | | |
| Interest | $ 636 | $ 160 |
| Income taxes | $ — | $ — |
| | | |
| Non-Cash Investing or Financing Transactions: | | |
| Tax benefit in connection with exercise of stock options | $ 31 | $ — |
| Issuance of common stock in exchange for subscription receivable | $ — | $ 133 |
| Acquisition of machinery and equipment in exchange for capital lease payable | $ 156 | $ 128 |
| Reclassification of equipment deposits to building and equipment | $ 389 | $ 735 |
| Series B-1 dividends paid with common stock | $ 284 | $ — |
| Series C-1 dividends paid with common stock | $ 41 | $ — |
| Accrual of Series B-1 dividends | $ 206 | $ — |
| Accrual of Series C-1 dividends | $ 206 | $ — |
| Change in fair value of interest rate swap | $ 15 | $ — |
| Declaration of preferred dividends | $ — | $ 124 |

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 1 - Condensed Consolidated Financial Statements**

The accompanying interim unaudited condensed consolidated financial statements include the accounts of Interpharm Holdings, Inc. and its subsidiaries that are hereafter referred to as (the "Company"). All intercompany accounts and transactions have been eliminated in consolidation.

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, such interim statements reflect all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position and the results of operations and cash flows for the interim periods presented. The operating results for the three and six months ended December 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the year ended June 30, 2006.

**NOTE 2 -** Summary of Significant Accounting Policies

Nature of Business

Interpharm Holdings, Inc., through its wholly-owned subsidiary, Interpharm, Inc. ("Interpharm, Inc."), is in the business of developing, manufacturing and marketing generic prescription strength and over-the-counter pharmaceutical products for wholesale distribution throughout the United States.

Revenue Recognition

The Company recognizes product sales revenue upon the shipment of product, when estimated provisions for chargebacks and other sales allowances are reasonably determinable, and when collectibility is reasonably assured. Accruals for these provisions are presented in the consolidated financial statements as reductions to revenues.

In addition, the Company is party to supply agreements with certain pharmaceutical companies under which, in addition to the selling price of the product, the Company receives payments based on sales or profits associated with these products realized by its customer. The Company recognizes revenue related to the initial selling price upon shipment of the products as the selling price is fixed and determinable and no right of return exists. The additional revenue component of these agreements is recognized by the Company at the time its customers record their sales and is based on pre-defined formulas contained in the agreements. Receivables related to this revenue of $958 and $620 at December 31, 2006 and June 30, 2006, respectively, are included in "Accounts receivable, net" in the accompanying Condensed Consolidated Balance Sheets.

Earnings Per Share

Basic earnings per share ("EPS") of common stock is computed by dividing net income attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted EPS reflects the amount of net income for the period available to each share of common stock outstanding during the reporting period, giving effect to all potentially dilutive shares of common stock from the potential exercise of stock options and warrants and conversions of convertible preferred stocks. In accordance with Emerging Issues Task Force ("EITF") Issue No. 03-6, "Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings

Per Share," during the fiscal year ended June 30, 2006, in periods when there was net income and Series K preferred stock was outstanding, the Company used the Two-Class Method to calculate the effect of the participating Series K on the calculation of basic EPS and the if-converted method was used to calculate the effect of the participating Series K on diluted EPS. In periods when there was a net loss, the effect of the participating Series K was excluded from both basic and diluted EPS. Additionally, in May 2006, the Series K preferred stock was converted into the Company's common stock; therefore the use of the Two-Class Method is not required for the three and six months ended December 31, 2006.

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 2 -** Summary of Significant Accounting Policies, continued

Use of Estimates in the Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include deferred tax asset valuations, reserve for chargebacks, deferred revenue, fair values of stock based compensation awards and inventory overhead costing estimates.

Stock Based Compensation

Effective July 1, 2005, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123 (Revised 2004), “Share-Based Payment,” (“SFAS No. 123(R)”), using the modified-prospective-transition method. As a result, the Company’s net loss before taxes for the three months ended December 31, 2006 and its net income before taxes for the three month period ended December 31, 2005 is lower by $375 and $200, respectively, and $586 and $416 for the six months ended December 31, 2006 and 2005, respectively, than if it had continued to account for share-based compensation under Accounting Principles Board (“APB”) opinion No. 25, “Accounting for Stock Issued to Employees” (“APB No. 25”).

Sales Incentives

In accordance with the terms and conditions of an agreement entered into during the prior fiscal year, the Company has offered a sales incentive to one of its customers in the form of an incentive volume price adjustment. The Company accounts for sales incentives in accordance with EITF 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of Vendor's Products)" (“EITF 01-9”). The terms of this volume based sales incentive required the customer to purchase a minimum quantity of the Company's products during a specified period of time. The incentive offered was based upon a fixed dollar amount per unit sold to the customer. The Company made an estimate of the ultimate amount of the incentive the customer would earn based upon past history with the customer and other facts and circumstances. The Company had the ability to estimate this volume incentive price adjustment, as there did not exist a relatively long period of time for the particular adjustment to be earned. Any change in the estimated amount of the volume incentive was recognized immediately using a cumulative catch-up adjustment. In accordance with EITF 01-9, the Company recorded the provision for this sales incentive when the related revenue is recognized. The Company's sales incentive liability may prove to be inaccurate, in which case the Company may have understated or overstated the provision required for these arrangements. Therefore, although the Company makes its best estimate of its sales incentive liability, many factors, including significant unanticipated changes in the purchasing volume of its customer, could have significant impact on the Company's liability for sales incentives and the Company's reported operating results. The specific terms of this agreement which related to sales incentives expired in October 2006. For the three and six months ended December 31, 2006, the Company recognized $232 and $3,399 sales incentive revenue related to this agreement.

Reclassifications

Certain reclassifications have been made to the audited condensed consolidated financial statements for the prior period in order to have them conform to the current period’s classifications. These reclassifications have no effect on previously reported net income.

The Company reclassified certain components of stockholders' equity section to reflect the elimination of deferred compensation arising from unvested share-based compensation pursuant to the requirements of Staff Accounting Bulletin No. 107, regarding Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment." This deferred compensation was previously recorded as an increase to additional paid-in capital with a corresponding reduction to stockholders' equity for such deferred compensation. This reclassification has no effect on net income or total stockholders' equity as previously reported. The Company will record an increase to additional paid-in capital as the share-based payments vest.

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 2 -** Summary of Significant Accounting Policies, continued

Recently Issued Accounting Pronouncements

New Accounting Pronouncements

In June 2006, The Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", ("FIN 48"). This interpretation clarified the accounting for uncertainty in income taxes recognized in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes" ("SFAS No.109"). Specifically, FIN 48 clarifies the application of SFAS No. 109 by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements. Additionally, FIN 48 provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods of income taxes, as well as the required disclosure and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact that the adoption of FIN 48 will have on its financial position and results of operations.

In February 2006, the FASB issued SFAS No. 155 "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140" ("SFAS 155"). SFAS 155 clarifies certain issues relating to embedded derivatives and beneficial interests in securitized financial assets. The provisions of SFAS 155 are effective for all financial instruments acquired or issued after fiscal years beginning after September 15, 2006. The Company is currently assessing the impact that the adoption of SFAS 155 will have on its financial position and results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets" ("SFAS 156"), which amends SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 permits the choice of the amortization method or the fair value measurement method, with changes in fair value recorded in income, for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. The statement is effective for years beginning after September 15, 2006, with earlier adoption permitted. The Company is currently evaluating the effect that adopting this statement will have on the Company's financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. It codifies the definitions of fair value included in other authoritative literature; clarifies and, in some cases, expands on the guidance for implementing fair value measurements; and increases the level of disclosure required for fair value measurements. Although SFAS 157 applies to (and amends) the provisions of existing authoritative literature, it does not, of itself, require any new fair value measurements, nor does it establish valuation standards. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. This statement will be effective for the Company's fiscal year beginning July 2008. The Company will evaluate the impact of adopting SFAS 157 but does not expect that it will have a material impact on the Company's consolidated financial position, results of operations or cash flows.

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 2 -** Summary of Significant Accounting Policies, continued

Recently Issued Accounting Pronouncements, continued

New Accounting Pronouncements, continued

In September 2006, the staff of the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 ("SAB 108") which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB 108 became effective in fiscal 2007. Adoption of SAB 108 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

**NOTE 3 - Accounts Receivable**

Accounts receivable are comprised of amounts owed to the Company through the sales of its products throughout the United States. These accounts receivable are presented net of allowances for doubtful accounts, sales returns and customer chargebacks. Allowances for doubtful accounts were approximately $62 at December 31, 2006 and $101 at June 30, 2006. The allowance for doubtful accounts is based on a review of specifically identified accounts in addition to an overall aging analysis. Judgments are made with respect to the collectibility of accounts receivable based on historical experience and current economic trends. Actual losses could differ from those estimates. Allowances for customer chargebacks were $2,568 and $2,315 at December 31, 2006 and June 30, 2006, respectively. The Company sells some of its products indirectly to various government agencies referred to below 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 actually purchase the products at these agreed-upon prices. The Company will provide credit to the selected wholesaler for the difference between the agreed-upon price with the indirect customer and the wholesaler’s invoice price if the price sold to the indirect customer is lower than the direct price to the wholesaler. This credit is called a chargeback. 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 increase, the reserve for chargebacks will also generally increase. However, the size of the increase depends on the product mix. The Company continually monitors the reserve for chargebacks and makes adjustments to the reserve as deemed necessary. Actual chargebacks may differ from estimated reserves.

The changes in the allowance for customer chargebacks, discounts and other credits that reduced gross revenue for six months ended December 31, 2006 and 2005 is as follows:

| | Six Months Ended December 31, | | | |
|---|---|---|---|---|
| | | 2006 | | 2005 |
| Reserve balance - beginning | $ | 2,315 | $ | 425 |
| Actual chargebacks, discounts and other credits taken in the current period (a) | | (5,014) | | (1,695) |
| Current provision related to current period sales | | 5,267 | | 3,177 |
| Reserve balance - ending | $ | 2,568 | $ | 1,907 |

(a) Actual chargebacks discounts and other credits are determined based upon the customer’s application of amounts taken against the accounts receivable balance.

11

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 4 - Inventories**

Inventories consist of the following:

| | December 31, 2006 (Unaudited) | June 30, 2006 |
|---|---|---|
| Finished goods | $ 1,010 | $ 1,781 |
| Work in process | 4,268 | 3,685 |
| Raw materials | 4,233 | 2,928 |
| Packaging materials | 296 | 312 |
| Total | $ 9,807 | $ 8,706 |

**NOTE 5 - Land, Building and Equipment**

Land, building and equipment consist of the following:

| | December 31, 2006 (Unaudited) | June 30, 2006 | Estimated Useful Lives |
|---|---|---|---|
| Land | $ 4,924 | $ 4,924 | — |
| Building | 12,460 | 12,460 | 39 Years |
| Machinery and equipment | 14,242 | 12,657 | 5-7 Years |
| Computer equipment | 891 | 151 | 5 Years |
| Construction in Progress | 560 | 587 | — |
| Furniture and fixtures | 686 | 660 | 5 Years |
| Leasehold improvements | 3,506 | 3,206 | 5-15 Years |
| | 37,269 | 34,645 | |
| Less: accumulated depreciation and amortization | 6,605 | 5,576 | |
| Land, Building and Equipment, net | $ 30,664 | $ 29,069 | |

Depreciation and amortization expense for the three and six months ended December 31, 2006 was approximately $541 and $1,029, respectively, and for the three and six months ended December 31, 2005, was approximately $346 and $692, respectively.

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 6 - Accounts Payable, Accrued Expenses and Other Current Liabilities**

Accounts payable, accrued expenses and other current liabilities consist of the following:

| | December 31, 2006 (Unaudited) | June 30, 2006 |
|---|---|---|
| Inventory purchases | $ 7,265 | $ 5,734 |
| Research and development expenses | 1,500 | 2,068 |
| Other | 4,470 | 4,848 |
| Total | $ 13,235 | $ 12,650 |

**NOTE 7 - Debt**

Long-term Debt

A summary of the outstanding long-term debt is as follows:

| | December 31, 2006 | June 30, 2006 |
|---|---|---|
| Revolving credit facility | $ — | $ — |
| Real estate term loan | 11,333 | 11,734 |
| Machinery and equipment term loans | 4,086 | 3,833 |
| Capital leases | 232 | 72 |
| | 15,651 | 15,639 |
| Less: amount representing interest on capital leases | 46 | 1 |
| Total long-term debt | 15,605 | 15,638 |
| Less: current maturities | 1,808 | 1,686 |
| Long-term debt, less current maturities | $ 13,797 | $ 13,952 |

During February, 2006, the Company entered into a new four-year financing arrangement with Wells Fargo Business Credit (“WFBC”). This financing agreement provided an original maximum credit facility of $41,500 comprised of:

- $22,500 revolving credit facility (the “facility”)
- $12,000 real estate term loan
- $ 3,500 machinery and equipment (“M&E”) term loan
- $ 3,500 additional / future capital expenditure facility

The funds made available through this facility paid down, in its entirety, the $20.45 million owed on the previous credit facility. The new revolving credit facility borrowing base is calculated as (i) 85% of the Company's eligible accounts receivable plus the lesser of 50% of cost or 85% of the net orderly liquidation value of its eligible inventory. The advances pertaining to inventory are capped at the lesser of 100% of the advance from accounts receivable or $9,000. The $12,000 loan for the real estate in Yaphank, NY is payable in equal monthly installments of $67 plus interest through February 2010 at which time the remaining principal balance is due. The $3,500 M&E loan is payable in equal monthly installments of $58 plus interest through February 2010 at which time the remaining principal balance is due. With respect to additional capital expenditures, the Company is permitted to borrow 90% of the cost of new equipment purchased to a maximum of $3,500 in borrowings amortized over 60 months. As of December 31, 2006, there was approximately $2,240 available for additional capital expenditure borrowings.

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 7 - Debt**, continued

Under the terms of the WFBC agreement, three stockholders, all related to the Company's Chairman of the Board of Directors, one of whom is our Chief Operating Officer, were required to provide limited personal guarantees, as well as pledge securities with a minimum aggregate value of $7,500 as security for a portion of the $22,500 credit facility. The Company was required to raise a minimum of $7,000 through the sale of equity or subordinated debt by June 30, 2006. The shareholder's pledges of marketable securities would be reduced by WFBC either upon the Company raising capital, net of expenses in excess of $5,000 or achieving certain milestones. As a result of the sale of $10,000 of Series B-1 redeemable convertible preferred stock in May 2006, the limited personal guarantees were reduced by $3,670. The sale of the $10,000 Series C-1 redeemable convertible preferred stock in September 2006, resulted in elimination of the balance of the personal pledges of marketable securities of $3,830.

The revolving credit facility and term loans will bear interest at a rate of the prime rate less 0.5% or, at the Company's option, LIBOR plus 250 basis points. At December 31, 2006, the interest rate on this debt was 7.75%. Pursuant to the requirements of the WFBC agreement, the Company put in place a lock-box arrangement, which will incur a fee of 25 basis points per annum on any unused amounts of this credit facility.

The WFBC credit facility is collateralized by substantially all of our assets. In addition, the Company is required to comply with certain financial covenants.

With respect to the real estate term loan and the $3,500 M&E loan, the Company entered into interest rate swap contracts (the "swaps"), whereby the Company pays a fixed rate of 7.56% and 8.00% per annum, respectively. The swaps contracts mature in 2010. The swaps are a cash flow hedge (i.e. a hedge against interest rates increasing). As all of the critical terms of the swaps and loans match, they are structured for short-cut accounting under SFAS No. 133, "Accounting For Derivative Instruments and Hedging Activities" and by definition, there is no hedge ineffectiveness or a need to reassess effectiveness. Fair value of the interest rate swaps at December 31, 2006, was approximately $83 and is included in other assets.

**NOTE 8- Income Taxes**

During the three and six month periods ended December 31, 2006, non-qualified stock options were exercised which generated approximately $9 and $83 of income tax deductions, respectively, resulting in tax benefits of approximately $3 and $31, respectively, which were credited to additional paid-in capital.

At December 31, 2006 the Company has remaining Federal NOLs of $20,847 and State NOLs of $20,257 available through 2026. Pursuant to Section 382 of the Internal Revenue Code regarding substantial changes in Company ownership, utilization of these NOLs is limited. As of December 31, 2006, the Company has determined that it is more likely than not, that the Company will utilize all of the Federal NOLs in the future. The Company recorded a valuation allowance of approximately 17% of the State NOLs which the Company does not anticipate utilizing due to State limitations.

In calculating its tax provision for the six month periods ended December 31, 2006 and 2005, the Company applied aggregate effective tax rates of approximately 27% and 38%, respectively, thereby creating a $922 income tax benefit and an income tax expense of $98, respectively, and adjusted its deferred tax asset by like amounts. The decrease in effective tax rates is the result of permanent tax differences relating to Incentive Stock Options.

INTERPHARM HOLDINGS, INC
(In thousands, except per share data)

**NOTE 9- Earnings Per Share**

The calculations of basic and diluted EPS are as follows:

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Numerator: | | | | |
| Net (loss) income | $ (4,124) | $ 609 | $ (2,494 | |